Chapter III

Regulatory Initiatives in the Financial Sector

Global regulatory efforts continued to focus on risks to financial stability associated with non-bank financial intermediation, crypto-assets and decentralised finance (DeFi), climate change, cyber risk and emerging technologies. Domestic regulatory measures were aimed at improving the resilience of financial intermediaries, easing compliance, reducing regulatory arbitrage, expanding secure digitalisation, development of derivative markets, ensuring customer protection and expanding access to finance while mitigating systemic risk. The Financial Stability and Development Council (FSDC) and its Sub-Committee remain committed to preserving the stability of the Indian financial system.

Introduction

3.1 Stress in banking systems in some jurisdictions during early 2023 subsided with forceful resolutions but a sizable tail of banks remains vulnerable to valuation loss in investment portfolios. As the global economy reconfigures after multiple shocks, regulators are refocusing on buttressing financial system resilience. Global regulatory initiatives specifically aim to address fragilities in non-bank financial intermediaries and certain segments of financial markets, leveraged lending, cyber risks, crypto-assets and DeFi. Several efforts are being made to integrate climate risk into existing regulatory and supervisory frameworks.

3.2 Against this backdrop, this chapter reviews recent regulatory efforts, international and domestic, to strengthen financial system stability and resilience.

III.1 Global Regulatory Developments and Assessment

III.1.1 Crypto-assets and Financial Stability

3.3 The focus of the G20 discussions on regulation of crypto-assets so far was on the potential risks associated with crypto-assets and limited to addressing concerns related to financial stability and integrity. The Indian G20 Presidency, however, laid the groundwork for formulating a globally consistent and coordinated policy and regulatory framework for crypto-assets. At the request of India under its G20 Presidency, the IMF and the Financial Stability Board (FSB) prepared a synthesis paper on crypto-assets[1], which combines policy recommendations of the IMF and the FSB {alongside SSBs (Standard Setting Bodies)}. Risks to financial stability emanating from cryptocurrencies are recognised in the synthesis paper in that the widespread adoption of crypto-assets could undermine the effectiveness of monetary policy, circumvent capital flow management measures, exacerbate fiscal risks, divert resources available for financing the real economy, and threaten global financial stability. It provides guidance for authorities to address macroeconomic and financial stability risks posed by crypto-asset activities and markets, including those associated with stablecoins and DeFi.

3.4 The paper suggests that regulation and supervision of licensed crypto-asset issuers and service providers can support the functioning of capital flow measures, tax policies with respect to crypto-assets, and financial integrity requirements.

[1] Financial Stability Board (2023), 'IMF-FSB Synthesis Paper: Policies for Crypto-Assets', September.

Regulation and appropriate reporting requirements can reduce data gaps, which are particularly important for capital flow measures that rely on monitoring of cross-border transactions and capital flows. Furthermore, it recommends that jurisdictions should implement the Financial Action Task Force (FATF) anti-money laundering and counter-terrorist financing (AML/ CFT) standards that apply to virtual assets and virtual asset service providers.

3.5 In July 2023, the FSB came out with a global regulatory framework for crypto-asset activities[2], based on the principle of 'same activity, same risk, same regulation'. It consists of: (i) high-level recommendations for the regulation, supervision and oversight of crypto-asset activities and markets; and (ii) revised high-level recommendations for the regulation, supervision, and oversight of global stablecoin arrangements (GSC). The recommendations establish a global regulatory baseline, but some jurisdictions (especially EMDEs) may also decide to take more restrictive regulatory measures. The aim is to promote a regulatory, supervisory and oversight framework that is technology-neutral and focuses on underlying activities and risks while fostering safe innovation. A broad approach to GSCs is envisaged that is intended to be flexible so that they can be incorporated into wider regulatory frameworks potentially applicable to GSCs around the world.

3.6 The Basel Committee on Banking Supervision (BCBS) published a consultation paper on disclosure of banks' crypto-asset exposures[3] with a proposed implementation date of January 1, 2025. Banks would be required to disclose qualitative information on their activities related to crypto-assets and quantitative information on exposures to crypto-assets with related capital and liquidity requirements according to their prudential and liquidity risk classification. Banks would also be required to provide details of accounting classifications relating to their exposures to crypto-assets. It is expected that a common format for disclosures will support the exercise of market discipline and help reduce information asymmetry between banks and market participants. The Basel Committee on Banking Supervision has also issued a public consultation document[4] on proposed amendments to its standards on banks' exposures to crypto-assets. The proposed changes elaborate the criteria on the composition of the reserve assets that back stablecoins and put in place a due diligence requirement to ensure that banks have an adequate understanding of their stabilisation mechanisms.

3.7 The International Organisation of Securities Commissions (IOSCO), the global standard setter for the securities markets, finalised its policy recommendations for crypto and digital asset markets[5]. The recommendations set a clear and robust international regulatory baseline to ensure that crypto-asset service providers (CASPs) meet the standards of business conduct that apply in traditional financial markets. They are aimed at addressing concerns related to market integrity and investor protection arising from crypto-asset activities. The recommendations are principle and activity based, and follow a 'lifecycle' approach in addressing the key issues and risks in crypto-asset markets. The recommendations cover six key areas: conflict of interest arising from vertical integration of activities and functions; market manipulation,

[2] Financial Stability Board (2023), 'FSB Global Regulatory Framework for Crypto-Asset Activities', July.

[3] Basel Committee on Banking Supervision (2023), 'Disclosure of Crypto-asset Exposures - Consultative Document', October.

[4] Basel Committee on Banking Supervision (2023), 'Crypto-asset Standard Amendments - Consultative Document', December.

[5] International Organization of Securities Commissions (2023), 'Policy Recommendations for Crypto and Digital Asset Markets – Final Report', November.

insider trading and fraud; custody and client asset protection; cross-border risks and regulatory cooperation; operational and technological risk; and retail distribution.

3.8 The IOSCO has also finalised its policy recommendations for Decentralised Finance (DeFi)[6] which aims to address market integrity and investor protection concerns arising from DeFi by supporting greater consistency of regulatory frameworks and oversight in member jurisdictions. They are complementary and interoperable to the policy recommendations for crypto and digital assets markets[7]. The recommendations are principle-based and outcome-focused, and aimed at DeFi products, services, activities, and arrangements that self-identify as decentralised, by applying IOSCO's widely accepted global standards for securities markets regulation. The report emphasises the need for enhanced cooperation among regulators to coordinate and respond to cross-border challenges in enforcement and supervision, and to address regulatory arbitrage concerns arising from the cross-border nature of global crypto-asset activities conducted by DeFi participants. The recommendations cover six key areas: understanding DeFi arrangements and structures; achieving common standards of regulatory outcomes; identification and management of key risks; clear, accurate and comprehensive disclosures; enforcement of applicable laws, and cross-border cooperation.

3.9 The BIS report[8] on the crypto ecosystem highlights congestion, fragmentation due to high fees, de-facto centralisation and the potential to amplify risks, as structural flaws in the crypto ecosystem. The report concludes that crypto has so far failed to harness innovation to the benefit of society, and several inherent limitations related to stability, efficiency, accountability, and integrity make it unsuitable to play a significant role in the monetary system.

3.10 The Financial Action Task Force (FATF), in June 2023, published its fourth targeted review of implementation of the FATF's Standards on virtual assets (VAs) and virtual asset service providers (VASPs), including the Travel Rule, and updates on emerging risks and market developments in this area. The report[9] notes that jurisdictions continue to struggle with fundamental requirements, such as, undertaking a risk assessment, enacting legislation to regulate VASPs, and conducting a supervisory inspection. Based on the FATF mutual evaluation and follow-up reports since the revised Recommendation 15 and its Interpretative Note (R.15/INR.15) were adopted, 75 per cent of jurisdictions are only partially or not compliant with the FATF's requirements. In addition, jurisdictions have made insufficient progress on implementing the Travel Rule, which is a key AML/CFT measure. This is a concern as the risks posed by VAs and VASPs continue to increase, necessitating appropriate risk identification and mitigation measures, and rapid implementation of FATF's standards on VAs and VASPs by all countries.

III.1.2 Markets and Financial Stability

3.11 Given the importance of central counterparties (CCPs) in financial systems for managing counter-party risk, especially since the introduction of clearing obligations for standardised over-the-counter (OTC) derivatives following the

[6] International Organization of Securities Commissions (2023), 'Policy Recommendations for Decentralised Finance (DeFi) – Final Report', December.

[7] International Organization of Securities Commissions (2023), 'Policy Recommendations for Crypto and Digital Asset Markets – Consultation Report', May.

[8] Bank for International Settlements (2023), 'The crypto ecosystem key elements and risks', July.

[9] Financial Action Task Force (2023), 'Virtual Assets: Targeted Update on Implementation of the FATF Standards on Virtual Assets and Virtual Asset Service Providers', June 27.

global financial crisis (GFC), their financial resilience in the face of losses and liquidity shortfalls has become important for financial stability. While the potential for losses arising from clearing member defaults is widely understood and recognised, there is limited common understanding of how CCPs should manage and address non-default losses (NDLs) that can even threaten a CCP's viability and its ability to continue providing services to the participants and the markets it serves. This is also enshrined in the Principles for Financial Market Infrastructures (PFMI). The Committee on Payments and Market Infrastructure (CPMI) of the Bank for International Settlements (BIS) and the IOSCO published a report[10] on current CCP practices highlighting the need for CCPs to have adequate resources and appropriate tools to address NDLs arising, for example, from investment risk or cyberattacks.

3.12 The leveraged loan market has evolved over time, shifting from traditional industrial sectors towards technology and healthcare. On average, the credit quality of corporate borrowers has deteriorated. Meanwhile, the investor base has moved from banks to non-banks especially collateralised loan obligations (CLOs)[11]. These changes, combined with a prolonged borrower-friendly environment, have led to rise in covenant-lite leveraged loans, increasing complexity of leveraged loan documentation and the use of earnings before interest, taxes, depreciation and amortisation (EBITDA) adjustments, which are often overly optimistic. Against this backdrop, the IOSCO published two reports calling for an improvement in practices in the leveraged loan market and highlighting lack of transparency in private finance with the objectives of protecting investors, ensuring that markets are fair and efficient, and reducing systemic risk. It identified vulnerabilities such as in the leveraged loan and CLO markets which may be exacerbated by the behaviour of certain participants and market practices.

3.13 The European Systemic Risk Board (ESRB) published a note describing the European Union (EU) regulatory framework for investment funds[12] and the prevention and mitigation of systemic risks related mainly to investment funds with large exposures to corporate debt and real estate. The policy options could apply to other fund types with vulnerabilities similar to those present in corporate debt funds and real estate funds. The note concluded that the resilience of investment funds with large exposures to corporate debt and real estate could be improved by adapting some of the policy tools already present in the regulatory framework. They include closer alignment between fund redemption terms and investment strategies, the use of anti-dilution liquidity management tools, and better preparedness for cash needs stemming from margins and/ or collateral calls in derivative and repo transactions.

III.1.3 Banking Supervision and Financial Stability

3.14 The BCBS issued a consultative document on revisions to the Core Principles for Effective Banking Supervision[13]. The review has incorporated several thematic topics reflecting developments in: (i) financial risks; (ii) operational resilience; (iii) systemic risk and macroprudential aspects of supervision; (iv) new risks, including climate-related financial risks and the digitalisation of finance; (v) non-bank financial intermediation; and (vi) risk management practices.

[10] Bank for International Settlements (2023), 'Report on Current Central Counterparty Practices to Address Non-default Losses' August.

[11] International Organisation of Securities Commissions (2023), 'Leveraged Loans and CLOs Good Practices for Consideration - Consultation Report', September.

[12] European Systemic Risk Board (2023), 'Issues Note on Policy Options to Address Risks in Corporate Debt and Real Estate Investment Funds from a Financial Stability Perspective, September.

[13] Basel Committee on Banking Supervision (2023), 'Consultative Document on Core Principles for Effective Banking Supervision', July.

3.15 The BIS-CPMI published a consultative report[14] issued as part of the G20 cross-border payments programme on linking fast payment systems across borders. It describes initial considerations (a) on governance and oversight for fast payment system (FPS) interlinking across borders and (b) to understand sensitivities, complexities and experiences in this area.

III.1.4 Artificial Intelligence and Financial Stability

3.16 Artificial Intelligence (AI) is rapidly changing how financial institutions are operated and regulated. While AI could bring considerable economic benefits, it also poses specific threats to financial stability. Taking these considerations into account, some jurisdictions such as the European Union, Canada and China are in the process of bringing out legislations on the development and use of AI.

3.17 The Artificial Intelligence Act passed by the European Union in December 2023 focuses on (a) ensuring that AI systems follow existing laws; (b) prescribing transparency requirements for large language model generative AI systems with stronger requirements for advanced models with systemic impact; (c) providing legal certainty to facilitate investment and innovations in AI; (d) safeguarding the use of AI and banning its exploitation of vulnerable sections of society; (e) emphasising the need for human oversight; and (f) enhancing governance on utilisation of AI systems and associated risks. It also aims to address ethical questions and implementation challenges in various sectors ranging from healthcare and education to finance and energy.

III.1.5 Cyber Risk and Financial Stability

3.18 Enhancing third-party cyber risk management has been an integral part of the work programme of the G7 Cyber Expert Group and the FSB. The use of third parties generally introduces additional risks which, if not properly managed, can lead to disruption in critical services of service providers. In response to concerns over risks related to outsourcing and third-party service relationships, the FSB has developed a toolkit[15] for third-party risk management and oversight that aims to reduce fragmentation in regulatory and supervisory approaches across jurisdictions and different areas of the financial services sector. The toolkit aims to strengthen the ability to manage third-party risks and facilitate coordination among relevant stakeholders.

3.19 In view of the rising instances of digital frauds, the BCBS has issued a discussion paper[16] regarding definitional issues, supervisory and financial stability implications for the global banking system (including existing data availability) and measures to mitigate such risks.

III.1.6 Climate Related Risks and Financial Stability

3.20 The International Sustainability Standards Board (ISSB) issued its inaugural standards — International Financial Reporting Standards (IFRS) S1 and IFRS S2 — on sustainability-related disclosures in capital markets worldwide[17] intended to improve trust and confidence in company disclosures. The Standards create a common language for disclosing the effects of climate-related risks and opportunities on a company's prospects. IFRS S1 provides a set of

[14] Committee on Payments and Market Infrastructures (2023), 'Linking Fast Payment Systems across Borders: Considerations for Governance and Oversight', October.

[15] Financial Stability Board (2023), 'Enhancing Third-Party Risk Management and Oversight - A toolkit for financial institutions and financial authorities - Consultative document', June.

[16] Basel Committee on Banking Supervision (2023), 'Discussion Paper on Digital fraud and Banking: Supervisory and Financial Stability Implications', November.

[17] https://www.ifrs.org/news-and-events/news/2023/06/issb-issues-ifrs-s1-ifrs-s2/ accessed on November 21, 2023.

disclosure requirements regarding sustainability-related risks and opportunities. IFRS S2 sets out specific climate-related disclosures and is designed to be used with IFRS S1. Both fully incorporate the recommendations of the Task Force on Climate-related Financial Disclosures.

III.2 Domestic Regulatory Developments

3.21 Since the release of the previous issue of the FSR, the Sub Committee of the Financial Stability and Development Council (FSDC-SC) chaired by the Governor, Reserve Bank of India met once on August 28, 2023. The Sub-Committee reviewed major global and domestic macroeconomic and financial developments, issues of inter-regulatory coordination relating to the Indian financial sector, activities of various technical groups under its purview, and the functioning of State Level Coordination Committees (SLCCs) in various States/ UTs.

3.22 The FSDC-SC resolved to remain vigilant against any build-up of vulnerabilities in all segments of the Indian financial system as well as in the broader economy, especially from global spillovers, and to preserve financial system stability for attaining strong, sustainable and inclusive growth.

III.3 Initiatives from Regulators/ Authorities

3.23 During the period under review, regulators in India undertook several initiatives to improve the robustness and resilience of the domestic financial system (Annex 3).

III.3.1 Regulatory Measures towards Consumer Credit and Bank Credit to NBFCs

3.24 Bank credit offtake in the retail segment, especially in the form of unsecured loans, registered strong and sustained growth. In view of concerns regarding exuberance and the potential build-up of stress in this segment, the Reserve Bank raised the risk weights on consumer credit exposure of commercial banks and NBFCs, and also on bank credit to NBFCs. The risk weights have been increased to 125 per cent from 100 per cent for consumer credit exposure (outstanding as well as new) of commercial banks and NBFCs, including personal loans, but excluding housing loans, education loans, vehicle loans, and loans secured by gold and gold jewellery. Additionally, microfinance/ SHG loans provided by NBFCs have also been excluded. The risk weights on credit card receivables of SCBs and NBFCs were also increased by 25 percentage points to 125 and 150 per cent, respectively.

3.25 The risk weight on exposure of SCBs to NBFCs, excluding loans to HFCs and loans to NBFCs which are eligible for classification as priority sector, were also increased by 25 percentage points (over and above the risk weight associated with the given external rating) in all cases where the extant risk weight as per external rating of NBFCs is below 100 per cent. Furthermore, regulated entities (REs) have been asked to review their extant sectoral exposure limits for consumer credit and put in place Board-approved limits in respect of various sub-segments under consumer credit.

III.3.2 Investments in Alternative Investment Funds (AIFs)

3.26 To address concerns relating to possible evergreening by regulated entities (REs) through AIFs by substitution of their direct loan exposure to borrowers with indirect exposure through investments in units of AIFs, the Reserve Bank issued guidelines on investments by REs in AIFs. Under these guidelines, REs have been advised not to make investments in any scheme of AIFs which has downstream investments either directly or indirectly in a debtor company of the RE[18].

[18] The debtor company of the RE, for this purpose, shall mean any company to which the RE currently has or previously had a loan or investment exposure anytime during the preceding 12 months.

3.27 It is further advised that if an AIF scheme, in which RE is already an investor, makes a downstream investment in any such debtor company, then the RE shall liquidate its investment in the scheme within 30 days from the date of such downstream investment by the AIF. In case REs are not able to liquidate their investments within the above-prescribed time limit, they shall make 100 per cent provision on such investments. In addition, investment by REs in the subordinated units of any AIF scheme with a 'priority distribution model'[19] shall be subject to full deduction from RE's capital funds.

III.3.3 Master Direction on Classification, Valuation and Operation of Investment Portfolio of Commercial Banks

3.28 The Reserve Bank issued Master Direction on classification, valuation and operation of the investment portfolios of commercial banks in view of significant developments in global standards on classification, measurement and valuation of investments, the linkages with the capital adequacy framework as well as progress in the development and functioning of the domestic financial markets. The directions require REs to classify investments into held to maturity (HTM), available for sale (AFS) and fair value through profit and loss (FVTPL) categories. Securities that do not qualify for inclusion in HTM or AFS categories shall be classified under the FVTPL category, while those held for trading (HFT) would be in a sub-category under FVTPL.

3.29 These principle-based norms for classification and reclassification of the investment portfolio are expected to bring in transparency in accounting and financial reporting. Under the revised directions, the symmetric recognition of gains/ losses for the MTM investment portfolio is expected to facilitate the use of derivatives for hedging and strengthening risk management. The enhanced disclosure requirements would give the granular position of the investment portfolio (including its fair value). The revised directions also allow non-SLR bonds to be held under the HTM category, which may provide fillip to the corporate bond market and align the accounting norms for banks' investment portfolios with global financial reporting standards.

III.3.4 Master Direction on Prudential Regulations for All India Financial Institutions (AIFIs)

3.30 With AIFIs increasingly being seen as key institutions to promote the flow of credit to productive sectors of the economy, the Reserve Bank has decided to implement a revised regulatory framework (including Basel III Regulations) for them {*viz.*, the National Bank for Agriculture and Rural Development (NABARD); the Export Import Bank of India (EXIM Bank); the Small Industries Development Bank of India (SIDBI); the National Housing Bank (NHB); and National Bank for Financing Infrastructure and Development (NaBFID)} to strengthen applicable prudential regulations and make their risk management systems more robust.

3.31 The revised regulatory framework entails extending the Basel III capital regulations applicable to banks, to AIFIs, replacing the currently applicable Basel I standards. The applicability of Basel III to AIFIs will *inter alia*: (i) raise capital standards; (ii) enable better recognition of credit risk, based on external ratings; (iii) allow the broad-based capturing of market risk instead of the simplified approach followed currently, and the recognition of operational risks; (iv) facilitate more efficient capturing of off-balance sheet exposures, under the leverage ratio framework; and (v) bring about the applicability of the large exposure framework (LEF) as in case of banks, thus setting prudential limits thereon. It also consolidates and updates the exposure norms, significant investments, classification, valuation

[19] 'Priority distribution model' shall have the same meaning as specified in the SEBI circular SEBI/HO/AFD-1/PoD/P/CIR/2022/157 dated November 23, 2022.

and operation of investment portfolio norms and resource raising norms.

III.3.5 Master Direction on Minimum Capital Requirements for Operational Risk

3.32 As part of the convergence with the revised BCBS standards on operational risk, the Reserve Bank issued Master Direction on minimum capital requirements for operational risk that are applicable to all commercial banks (excluding local area banks, payments banks, regional rural banks, and small finance banks). The directions require commercial banks to hold sufficient regulatory capital against exposures arising from operational risk.

3.33 The directions introduce the Basel III Standardised Approach for measuring minimum operational risk capital (ORC) requirements. Accordingly, banks are required to consider (a) a financial statement-based Business Indicator Component (BIC), and (b) bank-specific, loss data-based Internal Loss Multiplier (ILM) (for larger banks) in the calculation of ORC.

III.3.6 Regulation of Payment Aggregator – Cross Border (PA - Cross Border)

3.34 Entities facilitating cross-border transactions were carrying out their activities as online payment gateway service providers (OPGSPs) through a tie-up with Authorised Dealer (AD) banks. As activities of OPGSPs are more aligned with those of payment aggregators (PAs) that fall under the purview of Payment and Settlement Systems Act, 2007, fresh guidelines governing these entities have been issued in terms of the provisions of the Act.

3.35 The erstwhile OPGSPs have been renamed as Payment Aggregators – Cross Border (PA–CB). The inclusion of the PA–CBs within the direct regulatory ambit of the Reserve Bank has brought about regulatory harmonisation between domestic PAs and erstwhile OPGSPs while also safeguarding merchant (exporter/ importer) interest by introducing governance, risk management, cyber-security and customer grievance redressal standards for these entities. Non-bank PA–CBs, existing or new, have to seek authorisation for carrying out their activities from the Reserve Bank. The introduction of these instructions is expected to help in the orderly development of the sector while increasing options available to Indian exporters to showcase their products/ services to the world.

III.3.7 Corporate Debt Market Development Fund (CDMDF) - the Backstop Facility for Mutual Funds

3.36 In the light of disruptions in the corporate bond market due to the impact of the COVID-19 pandemic, an announcement in the Union Budget 2021-22 was made with regard to creation of a backstop facility for the corporate bond market that would purchase investment grade debt securities, both in stressed and normal times, and help in the development of the bond market. Accordingly, Department of Economic Affairs, Ministry of Finance, Government of India notified the establishment of Guarantee Scheme for Corporate Debt (GSCD) for the purpose of providing guarantee cover against debt to be raised by CDMDF which will act as a backstop in the corporate debt market in times of market dislocation. The GSCD is envisaged to be managed by the Guarantee Fund for Corporate Debt (GFCD), a Trust Fund formed by DEA with a corpus of ₹310 crore. The GFCD will be managed by National Credit Guarantee Trustee Company Ltd. (NCGTC).

3.37 The CDMDF is notified as an Alternative Investment Fund (AIF) in the form of a Trust under SEBI (AIF) Regulations. The units of CDMDF shall be subscribed to by asset management companies (AMCs) of mutual funds (MFs) and specified debt-oriented MF Schemes. Contribution to the Fund is mandatory for these AMCs and specified debt-oriented schemes, which would contribute a corpus of 0.25 per cent and 0.02 per cent of their AUM (one time), respectively (and subsequently, every six months on incremental AUM). The Fund is eligible to avail credit, based on guarantee of 10 times of the corpus (subject to maximum of ₹30,000 crore), backed by the NCGTC.

3.38 Activation of the backstop facility would be declared by the SEBI, which would allow the CDMDF to borrow funds and buy corporate debt securities from specified debt-oriented mutual fund schemes. In this regard, the SEBI has developed Financial Stress Indices (FSIs) to identify signals of extreme stress in the Indian corporate bond market for the consequent triggering of CDMDF. The SEBI would consider triggers generated by FSIs, along with qualitative factors for declaration of market dislocation.

III.3.8 Limited Purpose Clearing Corporation to Develop Repo Market in Corporate Bonds

3.39 A well-functioning repo market in corporate bonds can provide a short-term avenue to borrow funds against the holdings of corporate bonds in times of crisis rather than be forced to liquidate holdings at distress prices. The repo market in corporate bonds would require a clearing corporation with a robust risk management framework, including a Settlement Guarantee Fund (SGF), to manage and mitigate credit and counterparty risk.

3.40 In 2020, the SEBI proposed to set up a Limited Purpose Clearing Corporation (LPCC) through an amendment to the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018. Following various regulatory measures including specification of contribution by issuers of debt securities to Core SGF and enabling direct participation by entities *viz.* body corporates, NBFCs, insurance companies, mutual funds in LPCC for transacting in triparty repo for corporate bonds, the AMC Repo Clearing Limited (ARCL) has been operationalised in July 2023 as a LPCC. Presently, 1924 securities rated AA and above are eligible for triparty repo. 162 trades amounting to ₹15,810 crore have been undertaken till December 13, 2023.

3.41 The acceptance of debt securities as eligible collateral under repo transactions will impart more liquidity in the debt securities of such issuers which will, in turn, help issuers raise funds at relatively low cost. As the repo market benefits the issuers of debt securities, they are expected to have skin in the game in the case of failure of the underlying issuer. Keeping this in mind, all corporate bond issuers are mandated to contribute to the SGF at 0.50 basis points of the issuance value of debt securities per annum, based on the maturity of debt securities, to be collected upfront.

III.3.9 Customer Protection

3.42 The number of complaints received by the Offices of the Reserve Bank of India Ombudsman (ORBIOs) for the previous two quarters indicates that complaints pertaining to loans and advances and digital complaints (*i.e.*, complaints pertaining to mobile/ electronic banking, credit card and ATM/ CDM/ debit card) continued to constitute over 60 per cent during Q1 and Q2 of 2023-24 (Table 3.1).

Table-3.1. Category of Complaints Received under the RB-IOS, 2021

Sr. No.	Grounds of Complaint	RB-IOS (April-June 2023)		RB-IOS (July-Sept 2023)	
		Number	Share in per cent	Number	Share in per cent
1	Loans and Advances and Non-adherence to Fair Practices Code	16,607	24.03	17,732	23.55
2	Mobile/ Electronic Banking	12,604	18.23	12,588	16.72
3	Other Products and Services*	10,154	14.69	13,129	17.44
4	Credit Card	10,040	14.53	10,193	13.54
5	Opening/ Operation of Deposit accounts	9,081	13.14	9,371	12.45
6	ATM/ CDM/ Debit card	6,651	9.62	7,686	10.21
7	Others	1,342	1.94	1,959	2.60
8	Pension	1,084	1.57	928	1.23
9	Para-Banking	735	1.06	849	1.13
10	Remittance and Collection of instruments	822	1.19	845	1.12
Total		**69,120**	**100.00**	**75,280**	**100.00**

Note: * includes bank guarantee/ letter of credit, customer confidentiality, premises and staff, grievance redressal, death/ missing claims, among other things.
Source: RBI.

3.43 The total number of complaints received recorded around 9 per cent sequential (q-o-q) growth during Q2:2023-24.

III.3.10 Enforcement

3.44 During June 2023 – November 2023, the Reserve Bank undertook enforcement action against 146 REs (nine PSBs; six PVBs; one FB; one payments bank; one regional rural bank; 111 co-operative banks; 11 NBFCs; two HFCs and four credit information companies) and imposed an aggregate penalty of ₹57.07 crore for non-compliance with statutory provisions and/ or directions issued by the Reserve Bank.

III.4 Other Developments

III.4.1 Deposit Insurance

3.45 The Deposit Insurance and Credit Guarantee Corporation (DICGC) covers all banks operating in India and extends insurance to bank depositors with the objective of maintaining confidence in the banking system and promoting financial stability. As on September 30, 2023, the number of registered banks was 2,009, comprising 140 commercial banks (including 43 RRBs, two local area banks, six payments banks and 12 small finance banks) and 1,869 co-operative banks. The Deposit Insurance Fund (DIF) with the Corporation recorded a growth(y-o-y) of 17.5 per cent to reach ₹1,82,701 crore at end-September 2023.

3.46 With a deposit insurance limit of ₹5 lakh, 97.9 per cent of the total number of deposit accounts (287.1 crore) are fully protected. Of the total assessable deposits of ₹204.2 lakh crore, 44.2 per cent amounting to ₹90.3 lakh crore were insured as on September 30, 2023[20]. (Table 3.2).

Table-3.2. Coverage of Deposits

(Amount in ₹ crore and No. of Accounts in crore)

Sr. No.	Item	Quarter-ended			Percentage Variation	
		Sep-2022	Mar-2023	Sep-2023 (P)	H-o-H	Y-o-Y
	(1)	(2)	(3)	(4)	(5) = (4) over (3)	(6) = (4) over (2)
(A)	Number of Registered Banks	2,034	2,026	2,009	-	-
(B)	Total Number of Accounts	300.1	304.9	287.1	-5.8	-4.3
(C)	Number of Fully Protected Accounts	294.5	299.1	281.0	-6.1	-4.6
(D)	**Percentage coverage of accounts (C)/(B)**	**98.1**	**98.1**	**97.9**	-	-
(E)	Total Assessable Deposits	1,81,14,550	1,94,58,915	2,04,18,718	4.9	12.7
(F)	Insured Deposits	83,89,470	86,31,259	90,32,231	4.6	7.7
(G)	**Percentage coverage of amount (F)/(E)**	**46.3**	**44.4**	**44.2**	-	-

Note: P – Provisional.
Source: DICGC.

3.47 Due to the difference in average deposit size, the insured deposits ratio (*i.e.*, the ratio of insured deposits to assessable deposits) was higher for cooperative banks (63.9 per cent) than commercial banks (43.1 per cent) (Table 3.3).

3.48 Deposit insurance premium received by the DICGC grew by 10.6 per cent (y-o-y) to ₹11,628 crore during H1:2023-24, with 94.3 per cent contributed by commercial banks (Table 3.4).

3.49 The DIF with the DICGC is primarily built out of the premium paid by insured banks, recoveries from settled claims and investment incomes, net of income tax. DIF recorded an increase of 17.5 per cent (y-o-y) to reach ₹1.83 lakh crore in September 2023. The reserve ratio (*i.e.*, ratio of DIF to insured deposits) increased to 2.02 per cent from 1.85 per cent a year ago. (Table 3.5).

Table-3.3. Bank Group-wise Deposit Protection Coverage (As on September 30, 2023)

(₹ crore)

Bank Groups	No. of Insured Banks	Insured Deposits (ID)	Assessable Deposits (AD)	Insured Deposit Ratio (per cent)
(1)	(2)	(3)	(4)	(5) = (3) over (4)
I. Commercial Banks	**140**	**83,18,764**	**1,93,02,931**	**43.1**
i) Public Sector Banks	12	54,50,562	1,09,87,647	49.6
ii) Private Sector Banks	21	22,59,204	66,08,656	34.2
iii) Foreign Banks	44	51,562	9,31,135	5.5
iv) Small Finance Banks	12	77,667	1,84,714	42.0
v) Payments Banks	6	14,252	14,321	99.5
vi) Regional Rural Banks	43	4,64,626	5,75,228	80.8
vii) Local Area Banks	2	891	1,229	72.4
II. Cooperative Banks	**1,869**	**7,13,467**	**11,15,786**	**63.9**
i) Urban Cooperative Banks	1,484	3,64,573	5,33,501	68.3
ii) State Cooperative Banks	33	65,375	1,49,476	43.7
iii) District Central Cooperative Banks	352	2,83,520	4,32,810	65.5
Total	**2,009**	**90,32,231**	**2,04,18,718**	**44.2**

Source: DICGC.

Table 3.4: Deposit Insurance Premium

(₹ crore)

Period	Commercial Banks	Co-operative Banks	Total
2021-22	**18,248**	**1,242**	**19,490**
2021-22:H1	8,939	622	9,561
2021-22:H2	9,308	621	9,929
2022-23	**20,104**	**1,277**	**21,381**
2022-23:H1	9,872	641	10,513
2022-23:H2	10,232	636	10,868
2023-24:H1 (P)	10,962	666	11,628

Note: P - Provisional
Source: DICGC.

Table-3.5. Deposit Insurance Fund and Reserve Ratio

(₹ crore)

As on	Deposit Insurance Fund (DIF)	Insured Deposits (ID)	Reserve Ratio (DIF/ID) (Per cent)
September 30, 2022	1,55,459	83,89,470	1.85
March 31, 2023	1,69,602	86,31,259	1.96
September 30, 2023	1,82,701	90,32,231	2.02

Source: DICGC.

III.4.2 Corporate Insolvency Resolution Process (CIRP)

3.50 Since the inception of the Insolvency and Bankruptcy Code (hereinafter referred to as "the Code"), a total of 2,808 corporate debtors (CDs) have been rescued (808 through resolution plans; 1,053 through appeal or review or settlement; and 947 through withdrawal) and 2,249 corporate debtors have been referred for liquidation till end-September 2023 (Table 3.6 and 3.7).

Table-3.6. CIRP: Status as on September 30, 2023

Year/ Quarter	CIRPs at the beginning of the Period	Admitted	Closure by				CIRPs at the end of the Period
			Appeal/ Review/ Settled	Withdrawal under Section 12A	Approval of Resolution Plan	Commencement of Liquidation	
2016 - 17	0	37	1	0	0	0	36
2017 - 18	36	707	95	0	19	91	538
2018 - 19	538	1,157	155	97	77	304	1,062
2019 - 20	1,062	1,989	343	216	133	540	1,819
2020 - 21	1,819	537	89	162	121	350	1,634
2021 - 22	1,634	891	116	184	147	342	1,736
2022 - 23	1,736	1,261	172	200	184	409	2,032
Apr - Jun, 2023	2,032	247	36	44	42	96	2,061
Jul - Sep, 2023	2,061	232	46	44	85	117	2,001
Total	**NA**	**7,058**	**1,053**	**947**	**808**	**2,249**	**2,001**

Note: 1. These CIRPs are in respect of 6,784 corporate debtors.
2. The data excludes one corporate debtor, which moved directly from BIFR to resolution.

Source: Compilation from website of the NCLT and filing by IPs.

Table-3.7. Sectoral Distribution of CIRPs as on September 30, 2023

Sector	Number of CIRPs						
	Admitted	Closed					Ongoing
		Appeal/ Review/ Settled	Withdrawal under Section 12 A	Approval of Resolution Plan	Commencement of Liquidation	Total	
Manufacturing	**2,708**	**363**	**370**	**388**	**928**	**2,049**	**659**
Food, Beverages and Tobacco Products	355	44	46	45	125	260	95
Chemicals and Chemical Products	289	47	50	41	82	220	69
Electrical Machinery and Apparatus	192	23	21	14	82	140	52
Fabricated Metal Products	143	20	26	18	48	112	31
Machinery and Equipment	292	53	47	30	94	224	68
Textiles, Leather and Apparel Products	466	56	66	52	187	361	105
Wood, Rubber, Plastic and Paper Products	314	40	45	52	105	242	72
Basic Metals	458	53	39	107	146	345	113
Others	199	27	30	29	59	145	54
Real Estate, Renting and Business Activities	**1,508**	**282**	**230**	**118**	**414**	**1,044**	**464**
Real Estate Activities	414	89	55	35	68	247	167
Computer and related activities	204	25	35	13	73	146	58
Research and Development	9	2	2	1	1	6	3
Other Business Activities	881	166	138	69	272	645	236
Construction	**811**	**152**	**120**	**89**	**166**	**527**	**284**
Wholesale and Retail Trade	**698**	**91**	**68**	**57**	**292**	**508**	**190**
Hotels and Restaurants	**149**	**26**	**24**	**21**	**39**	**110**	**39**
Electricity and Others	**199**	**26**	**18**	**41**	**74**	**159**	**40**
Transport, Storage and Communications	**195**	**21**	**22**	**15**	**78**	**136**	**59**
Others	**790**	**92**	**95**	**79**	**258**	**524**	**266**
Total	**7,058**	**1,053**	**947**	**808**	**2,249**	**5,057**	**2,001**

Source: Insolvency and Bankruptcy Board of India (IBBI).

[20] September 2023 numbers are provisional.

Table-3.8. Outcome of CIRPs, Initiated Stakeholder-wise, as on September 30, 2023

Outcome	Description	CIRPs initiated by/for				
		Financial Creditor	Operational Creditor	Corporate Debtor	Financial Service Providers	Total
Status of CIRPs	Closure by Appeal/Review/Settled	320	725	8	0	1053
	Closure by Withdrawal u/s 12A	260	679	8	0	947
	Closure by Approval of Resolution Plan	462	281	62	3	808
	Closure by Commencement of Liquidation	1042	979	228	0	2249
	Ongoing	1057	827	116	1	2001
	Total	**3141**	**3491**	**422**	**4**	**7058**
CIRPs yielding Resolution Plans	Realisation by FCs as per cent of Liquidation Value	177.5	129.4	148.1	160.4	168.5
	Realisation by FCs as per cent of their Claims	33.8	18.3	18.4	42.4	31.9
	Average time taken for Closure of CIRP (days)	659	662	563	632	653
CIRPs yielding Liquidations	Liquidation Value as per cent of Claims	5.8	9.3	8.6	-	6.5
	Average time taken for Closure of CIRP (days)	493	468	394	-	472

Source: Insolvency and Bankruptcy Board of India (IBBI).

3.51 The end-September 2023 position for outcome of CIRPs indicates that of the operational creditor initiated CIRPs that were closed, nearly 53 per cent were closed on appeal, review, or withdrawal (Table 3.8). Such closures accounted for around 70 per cent of all such closures.

3.52 Several initiatives are being taken to improve the outcomes under the Code, including amendments in the regulations, increasing the effective strength of National Company Law Tribunal (NCLT), setting up of an integrated IT platform and regular interactions with the stakeholders including NCLT. Some of these initiatives have started yielding results with a rise in the admitted number of cases, the resolution plans approved and the realisable value (Table 3.9).

3.53 The primary objective of the Code is rescuing lives of CDs in distress. Through the resolution plans, the creditors have realised 168.5 per cent of the liquidation value and 86.3 per cent of the fair value (in CDs where fair value has been estimated). Furthermore, this realisation does not include the CIRP cost, and many probable future realisations such as equity, realisation from corporate and personal guarantees, funds infused into the CD including capital expenditure by the resolution applicants, and recovery from avoidance applications. Furthermore, as a result of behavioural change effectuated by the Code, many debtors are settling their dues even before the start of insolvency proceedings. Till end-August 2023, 26,518 applications for the initiation of CIRPs of corporate debtors having underlying default of ₹9.33 lakh crore were withdrawn before their admission.

3.54 As at end-September 2023, 2,249 CIRPs ended in liquidation of which nearly 77 per cent (1,713 out of 2,229 for which data are available) were with the Board for Industrial and Financial Reconstruction (BIFR) and/ or defunct. Even before they were admitted into CIRP, the economic value had almost eroded for most of these corporate

Table-3.9. Performance Trend of the Insolvency and Bankruptcy Code

Year	Number of Cases Admitted into CIRP	Number of Resolution Plans Approved	Realisable Value to the Creditors as a per cent of Admitted Claims under Resolution Plans (per cent)
2020-21	537	121	16.9
2021-22	891	147	22.4
2022-23	1261	184	37.1

Source: Insolvency and Bankruptcy Board of India (IBBI).

debtors and their assets, on an average were valued at only 7 per cent of the outstanding debt amount. Till end-September 2023, 597 corporate debtors have been completely liquidated with combined claims of ₹1.32 lakh crore against asset valuation of ₹0.06 lakh crore. The liquidation of these companies resulted in 90 per cent realisation of the liquidation value (Table 3.10).

Table-3.10. Liquidations where Final Report has been Submitted, till September 30, 2023

Number of Liquidations where Final Report submitted	Amount of Claims Admitted (₹ crore)	Liquidation Value (₹ crore)	Amount Realised (₹ crore)	Amount Distributed (₹ crore)
597	1,32,888	5,842	5,251#	5,244

Note: #Inclusive of unclaimed proceeds of ₹6.95 crore under liquidation.
Source: Insolvency and Bankruptcy Board of India (IBBI).

3.55 The Code endeavours to close the various processes at the earliest. The 808 CIRPs that have yielded resolution plans by September 2023 took an average of 541 days {after excluding the time excluded by the AA (Adjudicating Authority)} for conclusion of processes, while incurring an average cost of 1.23 per cent of liquidation value and 0.73 per cent of resolution value. Similarly, the 2,249 CIRPs that ended up in orders for liquidation took on an average 472 days for conclusion. Further, 597 liquidation processes, which have been closed by submission of final reports took on an average 536 days for closure. The 1,179 voluntary liquidation processes, which were closed by submission of final reports, took on an average of 408 days for closure.

III.4.3 National Stock Exchange IFSC[21] - Singapore Exchange Connect

3.56 The NSE IFSC-SGX Connect is a collaborative effort between the National Stock Exchange of India (NSE) and the Singapore Exchange (SGX). The NSE IFSC-SGX Connect presents an innovative pathway for international investors to gain exposure to the Indian equities market. It unifies both international and domestic participants, creating a deeper liquidity pool and an expanded shelf of Nifty products for investors. SGX has set up a subsidiary [*viz.*, SGX India Connect IFSC Private Limited (SGX-ICI)] in the GIFT-IFSC to act as a pass-through entity for orders routed through SGX.

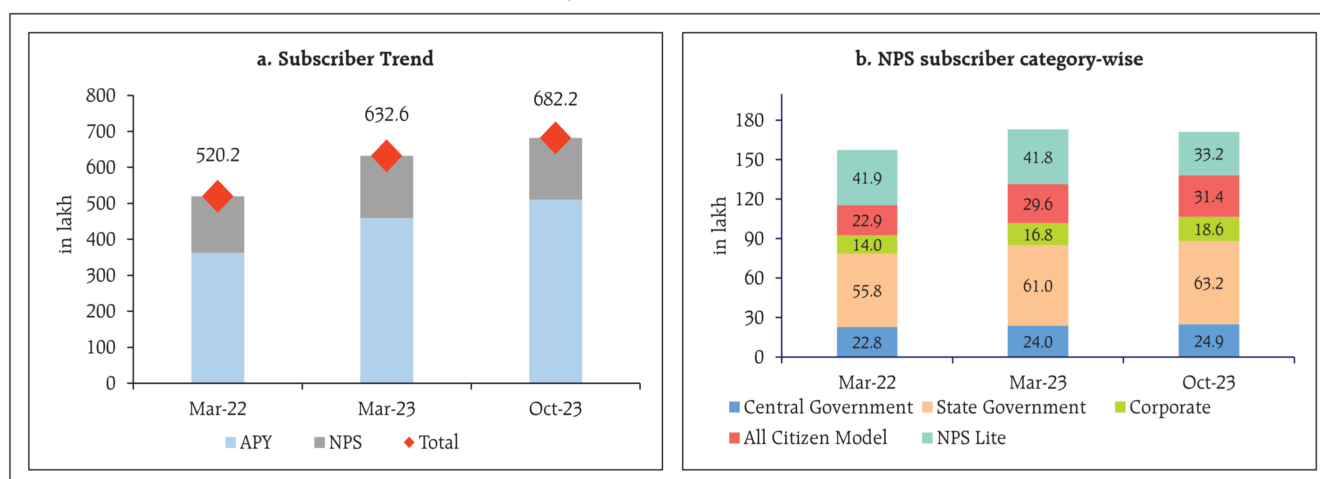
3.57 Full scale operations of the NSE IFSC-SGX Connect commenced in July 2023 with US$ 8.05 billion open interest in Nifty futures and over US$ 1.04 billion open interest in Nifty Options. Following the transition, all US dollar-denominated Nifty derivatives contracts are being exclusively traded on NSE IFSC. The average daily turnover of Nifty Derivative contracts on NSE International Exchange (NSE IX) (Oct 2023) was US$ 3.02 billion. Index Futures and Options of Nifty 50, Bank Nifty, Nifty IT and Nifty Financial Services contracts are available for trading for almost 21 hours daily in the GIFT-IFSC which overlaps Asia, Europe, and US trading hours. The NSE IFSC-SGX Connect is intended to give a boost to GIFT-IFSC as a global hub for international financial products and services.

III.4.4 Pension Funds

3.58 As at end-October 2023, the number of subscribers of the National Pension System (NPS) and Atal Pension Yojana (APY) have shown a growth of 7.8 per cent since March 2023 whereas the AUM has recorded a growth of 14.1 per cent during the same period. The number of subscribers under NPS and APY together has reached 6.82 crore and AUM

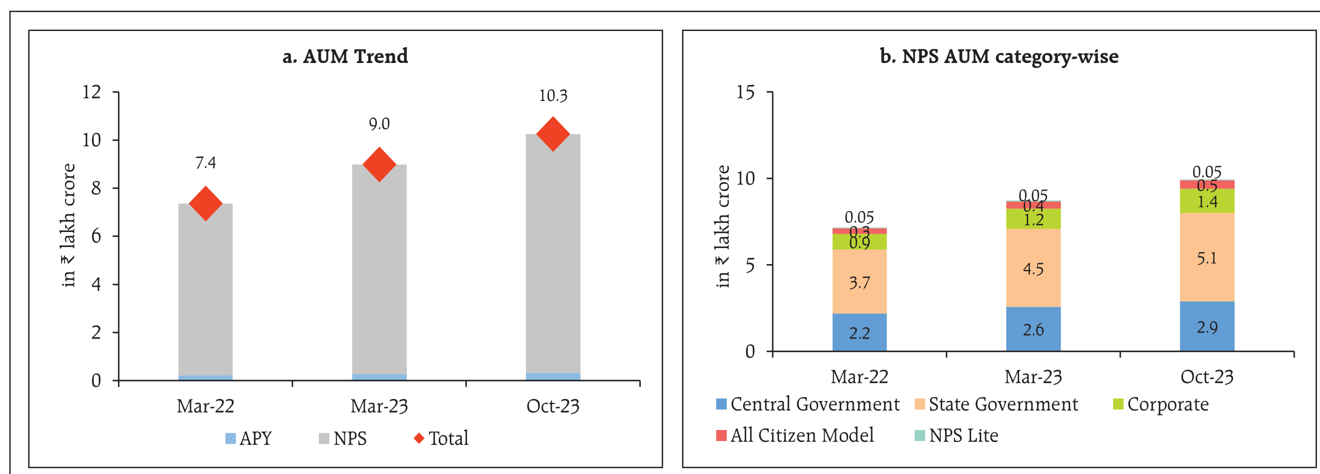
[21] International Financial Services Centre.

Chart 3.1: NPS and APY Subscribers



Source: Pension Fund Regulatory and Development Authority (PFRDA).

Chart 3.2: NPS and APY AUM



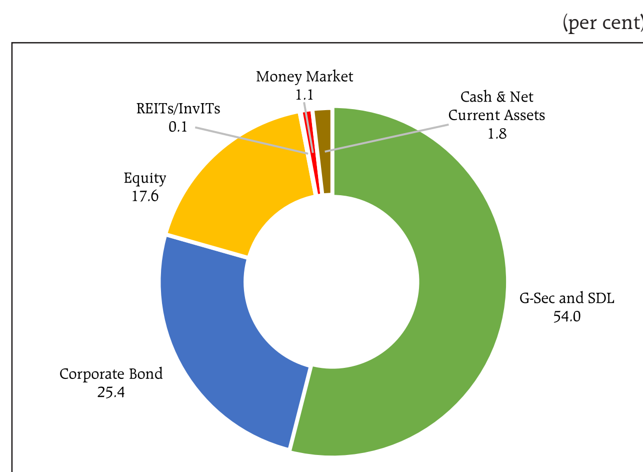
Source: PFRDA.

has touched ₹10.25 lakh crore (Chart 3.1 and 3.2), a majority of which is deployed in the Central and State government securities (Chart 3.3).

3.59 To boost the enrolments and expand the coverage under NPS and APY, the following initiatives were taken: (i) increase of entry age up to 70 years under NPS, (ii) online APY subscription through Aadhaar e-KYC, (iii) eNPS for government sector enrolment, (iv) use of Central KYC Records Registry (CKYCR), and (v) integration of NPS with Digilocker.

Chart 3.3: Asset Class-wise Bifurcation of AUM under All Products

(per cent)



Source: PFRDA.

III.4.5 Insurance

3.60 The Indian insurance industry, encompassing both life and general (including health) insurance has experienced consistent annual growth over the past years. Rising disposable income and awareness of the need for insurance and evolving customer preferences have contributed to the industry's growth. In the current fiscal year till October 2023, general and stand-alone health insurers recorded 14.7 per cent y-o-y increase in the premiums underwritten; however, the first-year new business premium witnessed a decline of 10.5 per cent for the life insurance sector.

3.61 To enhance insurance penetration in the country and to address existing protection gaps, IRDAI has been bringing in reforms in the regulatory framework governing the Indian insurance sector. To empower policyholders with deeper understanding of their insurance coverage, IRDAI mandated issuance of a concise and updated Customer Information Sheet (CIS) to the policyholders. The CIS is designed to provide policyholders all important information about their health insurance policy in simple language in a snapshot which, among others, includes details such as policy name, coverage, waiting periods, limits, exclusions, and key concepts. To accelerate the last-mile delivery of insurance services, the State Insurance Plan has been introduced with the objective of identifying the focus areas for insurance inclusion in each state in collaboration with insurers, state governments, and district-level administrators. In this direction, life, general and health Insurers have been allocated State(s) and Union Territories designating them as the Lead Insurers for allocated State/ UT. State Level Insurers' Committees and District Level Insurers' Committees are being constituted for seamless implementation of the Plan in the States.

3.62 To achieve the objective of "Insurance for all', a women-centric distribution model has been proposed due to its effectiveness in building trust and explaining the importance of insurance. The IRDAI has issued guidelines on Bima Vahaks[22], a women-centric dedicated distribution channel for enhancing insurance inclusion and awareness with a focus on rural areas, with each gram panchayat having a 'Vahak' to sell and service simple insurance products. Bima Vahaks will have a key role in taking Bima Vistaar, an all-in-one affordable insurance product offering life, health, and property cover for rural households with the aim of financial inclusion and social security.

3.63 To enhance the reinsurance business and streamline regulatory provisions for Indian Insurers, including Foreign Reinsurance Branches (FRBs) and IFSCA Insurance Offices (llOs), the IRDAI (Re-insurance) (Amendment) Regulations 2023 have been issued. The key changes introduced include *inter alia* (i) Indian Reinsurers (including FRBs) to maintain a minimum retention of 50 per cent within India of the Indian reinsurance business underwritten, (ii) a new and simplified Order of Preference (from six levels to four levels) which Cedant insurers are required to follow for all reinsurance placements, (iii) relaxing certain compliance and reporting requirements, and (iv) reducing minimum capital requirement for opening new FRBs from ₹100 Crore to ₹50 Crore, with the provision to repatriate any excess assigned capital. The amendment regulations signify a major shift in India's reinsurance landscape, fostering a more favourable business environment and positioning the country as a leading global reinsurance hub.

[22] A 'Bima Vahak' means an individual or a legal person (*i.e.*, Corporate Bima Vahak) who will act on behalf of its partner insurers to solicit business of 'Bima Vistaar', issue and service insurance policies, and assist the policyholders with claims.

3.64 To align the insurance sector with global needs and industry dynamics, the IRDAI formed mission mode teams to implement a Risk Based Supervisory (RBS) framework and a Risk Based Capital (RBC) regime. The IRDAI has been engaging with various stakeholders towards developing and implementing 'Risk Based Supervision' (RBS) framework for insurance sector in India. In this direction, the first phase of pilots for RBS has commenced from July 2023. With respect to RBC, IRDAI issued Technical Guidance Document in respect of Indian Risk Based Capital Framework – Quantitative Impact Study-1 (QIS-1). The QIS-1 shall be the first major step towards desired transformation and shall help in assessing the likely impact on the Indian insurance industry of the proposed framework for quantification of capital and solvency requirements following a risk-based approach.

Summary and Outlook

3.65 Global regulatory efforts remain focused on addressing vulnerabilities in non-bank financial intermediation, given the growing size and intermediation capacity of the NBFI sector. The ongoing endeavour is to ensure that NBFIs better manage risks through timely and granular public data disclosures and governance requirements. Management and mitigation of NDLs by CCPs, which is critical in view of implications for financial market services, is getting increasing attention. Ongoing challenges emanating from cyber risk and climate-related risk are the two other major focus areas for policy makers. Wider adoption of technology in the financial system amidst a new wave of innovations also poses new challenges for financial stability that would require suitable risk mitigating regulatory and supervisory actions.

3.66 Domestic regulatory initiatives have been conditioned by changes in the macro-financial environment, alignment with evolving global standards and consolidation of past gains. Initiatives have been aimed at convergence of domestic regulatory standards on valuation of banks' investment portfolio valuation and operational risk capital requirements with global standards. Macro-prudential measures are being strengthened to address systemic risk emerging from banks' and NBFCs' unsecured retail credit portfolios. In addition, other regulatory measures are aimed at improving the resilience of financial intermediaries, easing compliance, reducing regulatory arbitrage, expanding secure digitalisation, taking forward the development of derivative markets, improving efficiency of the markets, ensuring customer protection and expanding access to finance. Regulators remain vigilant to the rapidly changing economic environment in order to ensure the efficiency and soundness of the financial system, preserve financial stability and secure efficient functioning of markets.