VI REGULATION, SUPERVISION AND FINANCIAL STABILITY

Following the economic slowdown and sector-specific factors, the banking sector has been beset with the problem of deteriorating asset quality. In response, the Reserve Bank focused on strengthening the regulatory and supervisory framework to identify stress at the incipient stage and initiate corrective action. Alongside, the Reserve Bank sought to infuse competition in the banking sector by allowing new private sector banks and differentiated banks. Asset reconstruction companies were also encouraged for recovery management. Simultaneously, focus was placed on aligning the regulatory framework for NBFCs and UCBs with the rest of the banking sector. In pursuance of customer protection, the Reserve Bank released the Charter of Customer Rights, enunciating five basic rights for bank customers.

VI.1 The year under review was marked by rising financial stability risks worldwide - uncertainty surrounding the normalisation of monetary policy in the US and market reactions to incoming data that prompted risk-on risk-off switches in sentiment, asset prices and capital flows around its timing; highly accommodative monetary policies in the euro area and Japan with large swings in financial asset prices; and financial rebalancing and managing domestic vulnerabilities in emerging market economies, higher corporate indebtedness and growing exposure to market and liquidity risks. Against this backdrop, safeguarding financial stability through well-designed macro-prudential measures addressing both banking and non-banking constituents of the financial system assumed critical importance.

VI.2 With asset quality and profitability of banks coming under stress due to a combination of global and domestic developments, the Reserve Bank's focus during 2014-15 was on strengthening the regulatory and supervisory frameworks by aligning them with Basel III norms and also with those established by other international standard setting bodies.

VI.3 The regulatory and supervisory regime for non-banking financial companies (NBFCs) and urban cooperative banks (UCBs) was also fortified by aligning it with that of the banking system while promoting technological upgradation and sharing credit histories of borrowers. The banking structure itself was sought to be strengthened by infusion of new entrants, including in niche domains, such as small finance and payments banks and by extending the reach of the payment system infrastructure by bringing into its fold non-bank authorised entities. The Reserve Bank also signed memoranda of understandings (MoUs)/ exchange of letters/ statements of cooperation with a host of supervisors of other countries to promote greater cooperation and sharing of supervisory information relating to Indian banks with overseas operations and foreign banks operating in India.

VI.4 A critical area in the banking space that warranted prioritised attention was the mounting overhang of stressed assets. Besides mechanisms for early corrective actions, a multi-pronged strategy was adopted comprising higher provisioning against restructured assets, recovery management through asset reconstruction companies and strategic debt restructuring.

VI.5 Towards this end, various departments of the Reserve Bank dealing with the regulation and supervision of financial intermediaries as also

customer interest set out for themselves an agenda of work plans in 2014-15. The following paragraphs outline the activities undertaken by them, the challenges faced and the way forward for 2015-16.

FINANCIAL STABILITY UNIT (FSU)

VI.6 In the aftermath of the global financial crisis, maintaining financial stability has emerged as a prime responsibility of central banks. FSU of the Reserve Bank was set up in July 2009 to monitor stability related matters with the objective of strengthening the financial system. This is envisaged to be achieved by conducting macro-prudential surveillance on an on-going basis, systemic stress tests and dissemination of the status of financial stability in addition to supporting the institutional mechanism for financial stability in the country, *viz.,* Financial Stability and Development Council (FSDC).

Agenda for 2014-15: Implementation Status

VI.7 As planned for 2014-15, two Financial Stability Reports (FSRs) were published - one in December 2014 and the other in June 2015. It is the endeavour of the Reserve Bank to bring about improvements to its stress testing framework. Accordingly, refinements were made to the macro stress testing methodology with respect to the variables used (*e.g.,* using the consumer price index (CPI) instead of the wholesale price index (WPI), and weighted average lending rate in place of call rate). In addition, FSU collaborated with the International Monetary Fund (IMF) in the areas of modelling risk weighted asset (RWA) dynamics and modelling corporate sector distress and its impact on the banking sector in order to make further refinements in the stress testing framework as also to develop new predictive models. Analyses of power and iron and steel industries, with emphasis on stressed assets were undertaken. Further, their impact on the banking sector was assessed to gauge the resilience of the banking system.

VI.8 As the secretariat to the sub-committee of FSDC, FSU conducted three meetings of the sub-committee during 2014-15. The sub-committee's recommendation for putting in place an enabling framework for creating an 'account aggregation' facility for customers to view all their financial assets through a single window, is being worked out. Based on the discussions in the sub-committee, the Central Registry of Securitisation, Asset Reconstruction and Security Interest of India (CERSAI) will be acting as the central know your customer (KYC) registry to ensure both uniformity in the approach to KYC and its inter-usability across the financial sector.

VI.9 Drawing on the sub-committee's recommendations, various steps have been taken to strengthen State Level Coordination Committees (SLCCs) to make them more effective in the dissemination of market intelligence on unauthorised deposit taking schemes. Enactment of the Protection of Interests of Depositors' (PID) Act has been undertaken across a number of states/ union territories.

VI.10 Based on the sub-committee's direction to capture information on lending by insurance companies to corporates, insurance companies were advised to subscribe to the Central Repository of Information on Large Credits (CRILC), a repository of information on large credits set up by the Reserve Bank.

VI.11 Further, FSU also serves as the secretariat for the inter-regulatory technical group (IRTG), a sub-group of the FSDC sub-committee and in this capacity it conducted four meetings during 2014-15, in which issues such as legal entity identifier (LEI), reporting of lending against shares by NBFCs, account aggregation and common KYC,

among others, were discussed. The IRTG has advised all regulators to draw a road map to mandate use of LEI by entities identified in their jurisdiction.

Agenda for 2015-16

VI.12 Going ahead, conducting macro-prudential surveillance and publishing FSR in December 2015 and June 2016 are envisaged along with conducting meetings of the FSDC sub-committee. FSU will continue to undertake analyses of some of the critical industrial sectors. In addition, it is also proposed to collaborate with international agencies/ other central banks to review the tools and techniques used for conducting stress tests.

REGULATION OF FINANCIAL INTERMEDIARIES

Commercial Banks: Department of Banking Regulation (DBR)

VI.13 On the banking regulation front, the Reserve Bank strives to ensure a robust and resilient banking system in line with the best international practices capable of catering to the financial and associated needs of all sections of society efficiently and effectively. Accordingly, the department initiated a number of measures in 2014-15 for strengthening the banking structure.

Agenda for 2014-15: Implementation Status

Basel III Liquidity Standards

VI.14 During 2014-15, significant progress was made towards implementation of the two Basel III Liquidity Ratios - liquidity coverage ratio (LCR) which is set to impart resilience in the short term liquidity risk profile of banks, and the net stable funding ratio (NSFR) that seeks to limit over-reliance on short-term wholesale funding. While LCR was phased in for Indian banks with a minimum requirement of 60 per cent from January 1, 2015, NSFR is set to be implemented at the minimum requirement of 100 per cent from January 1, 2018.

Basel III Leverage Ratio (LR)

VI.15 In line with the Basel Committee on Banking Supervision (BCBS), the Reserve Bank issued a revised framework for LR in January 2015 as a credible supplement to risk-based capital requirements. While the final minimum LR for Indian banks will be stipulated in line with the final rules to be prescribed by BCBS by end-2017, the Reserve Bank will meanwhile monitor individual banks against an indicative LR of 4.5 per cent as part of a parallel run and also for the purpose of public disclosure of Tier 1 LR by banks.

Countercyclical Capital Buffer (CCCB) Framework

VI.16 Guidelines on implementation of CCCB in India have been issued covering aspects, such as constituents of CCCB, main and supplementary indicators to decide CCCB activation and calibration of CCCB based on indicators. Implementation of this buffer requirement will be pre-announced with a lead time of four quarters so as to provide sufficient time to meet CCCB requirements.

Framework for Dealing with Domestic Systemically Important Banks (D-SIBs)

VI.17 In line with the global practice of identifying global systemically important banks (G-SIBs), the Reserve Bank has released the framework for dealing with D-SIBs, which discusses the methodology for identifying D-SIBs and additional regulatory/ supervisory policies for them. The names of banks classified as D-SIBs will be disclosed in August every year starting from 2015.

Large Exposures Framework

VI.18 The danger of concentration of a bank's assets with a single counterparty or a group of

connected counterparties poses a systemic risk. Accordingly, the Reserve Bank has proposed a regulatory framework in line with international best practices to address the concerns arising from large exposures of banks and to prevent building up of concentrated exposures (Box VI.1).

Partial Credit Enhancement on Corporate Bonds

VI.19 During 2014-15, ways to incentivise corporates to reduce dependence on bank finance for their long-term resource requirements were explored. Pursuant to this, draft guidelines were issued to banks to provide partial credit enhancement to corporate bonds. The final guidelines in this regard are underway.

Revitalising Stressed Assets

VI.20 Towards greater alignment of prudential norms on project finance with international best practices, banks were allowed to extend structured

Box VI.1
Discussion Paper on Large Exposures (LE) Framework and Enhancing Credit Supply through the Market Mechanism

Internationally, concentration risk has been addressed by prescribing regulatory and statutory limits on exposures towards counterparties and various sectors of the economy. Since 1989, the Reserve Bank has been prescribing regulatory limits on a bank's exposures to its single and group borrowers. At present, the exposure limits stand at 15 per cent and 40 per cent of capital funds (CFs), respectively. On account of exposures towards infrastructure sector and further on the special discretion of the board of a bank, these exposure limits can be taken up to 25 per cent and 55 per cent of its CFs, respectively. Besides, there are certain other specific counterparty, sectoral and activity-based exposure limits (Table 1).

In order to ensure regulatory convergence in the area of large exposures internationally, the Basel Committee on Banking Supervision (BCBS) issued the 'Supervisory Framework for Measuring and Controlling Large Exposures' in April 2014 that will be fully applicable from January 1, 2019. Accordingly, the sum of all the exposure values of a bank to a single counterparty or to a group of connected counterparties must, at all times, not be higher than 25 per cent of the bank's available eligible capital base, *i.e*, the effective amount of Tier 1 capital fulfilling the criteria defined in the Basel III capital framework.

The Reserve Bank has sought to align exposure limits (both single and group) in India with the BCBS LE framework. In this context, a discussion paper on the proposed LE framework was issued on March 27, 2015. The discussion paper also contained proposals on enhancing credit supply to large corporates through the market mechanism (corporate bonds, commercial papers and other instruments).

Table 1: Major Exposure Limits

Specific Counterparty/ Sector/ Activity	Regulatory Exposure Limits
NBFCs predominantly engaged in loan against gold jewellery	7.5 per cent of CFs; can exceed by 5 per cent of CF for infrastructure
Other NBFCs (excluding AFCs/ IFCs)	10 per cent of CFs; can exceed by 5 per cent of CF for infrastructure
Direct Capital Market Exposures	20 per cent of net worth
Total Capital Market Exposures	40 per cent of net worth
Borrowing from the Call Money Market	100 per cent of CFs on a fortnightly average basis; can increase up to 125 per cent of CF on any day
Lending to the Call Money Market	25 per cent of CFs on a fortnightly average basis; can increase up to 50 per cent of CF on any day
Inter-Bank Liabilities	200 per cent of net worth as on 31 March of the previous year; can increase up to 300 per cent of the net worth for banks having minimum CRAR of 11.25 per cent
Investment in instruments issued by other banks/ FIs and eligible for capital status for the issuing bank/ FI	10 per cent of CF*
Investments in equity shares of other banks	5 per cent of the investee bank's equity capital*
Leasing, Hire Purchase and Factoring Services	10 per cent of total advances of a bank for each of such activities

*: A bank/ FI's equity holdings in another bank held under provisions of a statute will be outside the purview of the ceiling prescribed.
AFCs: Asset Finance Companies; IFCs: Infrastructure Finance Companies; CRAR: Capital to Risk-Weighted Assets Ratio; FIs: Financial Institutions.

(Contd....)

Under the proposed LE framework, a large exposure is one where the sum of all exposure values of a bank to a counterparty or a group of connected counterparties, is equal to or above 10 per cent of the bank's eligible capital base. Further, exposures to the central government, the Reserve Bank, intra-day inter-bank exposures, intra-group exposures and clearing exposures of qualified central counterparties are exempt from the LE limit. The LE Framework also prescribes differential exposure limits for certain counterparties, such as non-banking financial companies (NBFCs) and systemically important banks (SIBs), both global and domestic (G-SIBs and D-SIBs). Connected counterparties are proposed to be identified on the basis of 'control' as well as 'economic interdependence' criteria as against only the 'control' criteria under the extant exposure norms.

Computation of exposures under the LE framework will be permitted after taking into account credit risk mitigation adjustment based on risk-based capital framework techniques. Under the framework, banks may also be required to use 'look through approach' for assigning exposures to the underlying counterparties in structured products.

An internal study of the 20 largest group borrower exposures of the 10 largest banks has revealed that average exposure to groups of connected counterparties is 10.6 per cent of their CF as against the current permissible limit of 40 per cent of CF. In terms of Tier 1 capital, the present average exposure is 14.75 per cent as against the proposed LE limit of 25 per cent. Therefore, it is assumed that banks will not face any material difficulty with regard to their group exposures while adhering to the proposed LE limit.

long-term project loans with tenors up to 80 per cent of the initial economic life of a project, with a periodic refinancing option to avoid asset liability mismatch, fund cost over-runs up to a limit and extend the date of commencement of commercial operations (DCCO) subsequent to the change in ownership of the borrowing entity. These measures are expected to further strengthen banks' abilities to deal with complexities in project finance.

Strategic Debt Restructuring (SDR)

VI.21 With a view to enhancing banks' capabilities to initiate change in ownership for accounts which fail to achieve the projected viability milestones under a restructuring package, the Reserve Bank introduced a SDR scheme in June 2015. Under SDR, secured creditors of a Joint Lenders' Forum (JLF) can convert their loan dues into equity shares at a 'fair price' as per the pricing formula prescribed by the Reserve Bank, which has been exempted from the SEBI's ICDR (Issue of Capital and Disclosure Requirements) Regulations, 2009 subject to certain conditions. Lenders under JLF should collectively become majority shareholders post conversion. SDR will not be treated as restructuring for the purpose of asset classification and provisioning. JLF can appoint a suitable professional management to run the affairs of the company and should divest its holdings at the earliest. In this regard, the proposal of a comprehensive Bankruptcy Code in the Union Budget, 2015-16 is expected to bring about speed, clarity, predictability and fairness to the restructuring and recovery process (Box VI.2).

Treatment of Wilful Defaulters and Non-Cooperative Borrowers (NCBs)

VI.22 Regulations governing treatment of wilful defaulters and NCBs having aggregate fund-based and non-fund based facilities of ₹50 million from a bank/ financial institution (FI) were strengthened during 2014-15 and banks/ FIs were mandated to put in place transparent mechanisms for identifying NCBs as also for reporting.

Two New Entrants in the Banking Domain

VI.23 In its endeavour to foster healthy competition, the Reserve Bank laid out a framework for licensing new banks in the private sector in February 2013. Accordingly, in-principle approval was granted in April 2014 to IDFC Limited, an NBFC, and Bandhan Financial Services Private Limited, an NBFC-MFI (micro-finance institution) to set up banks. In June-July

Box VI.2
Bankruptcy Procedures in India

Stronger bankruptcy laws enable a sound debtor-creditor relationship by protecting the rights of both debtors and creditors; promoting predictability; clarifying the risks associated with lending; and ensuring efficient collection of debt through bankruptcy proceedings. The Union Budget 2015-16 identified bankruptcy law reforms as a key priority and proposed a comprehensive Bankruptcy Code in line with global standards to provide for necessary judicial capacity. It is envisaged to bring about legal certainty, speed and also improve the ease of doing business.

At present, there is no comprehensive policy/ law on corporate bankruptcy in India. The Sick Industrial Companies (Special Provisions) Act (SICA), 1985 remains to date the most important corporate restructuring law in force for revival and rehabilitation of sick companies, despite its well-recognised drawbacks. Other legislative attempts to overhaul the corporate rescue regime in India have not yet been made operational. For instance, Chapter XIX of the Companies Act, 2013 that provides for a broader, more balanced corporate rescue procedure applicable to all companies has not been notified for commencement. Similarly, Chapter VIA of the Companies Act, 1956, inserted by the Companies (Second Amendment) Act, 2002, which provides for the National Company Law Tribunal (NCLT) to exercise powers in relation to sick industrial companies remains to be notified.

With a view to overcoming the existing inadequacies, the Bankruptcy Law Reform Committee (BLRC) (Chairman: Shri TK Vishwanathan) was established in August 2014 and entrusted with the task of examining the present legal framework for corporate insolvency and suggesting immediate reforms; and developing an 'Insolvency Code' for India covering all aspects of personal and business insolvency. Salient recommendations of the BLRC made in line with international best practices are:

- A secured creditor can initiate rescue proceedings if the debtor company fails to pay a single undisputed debt above a prescribed value within 30 days of a notice of demand; or pre-emptively on the grounds of likelihood of inability to pay debt.
- Unsecured creditors representing 25 per cent of the debt can initiate rescue proceedings against the debtor company.
- Once a company has been declared sick, 75 per cent of the secured creditors in value should be able to appoint a company administrator directly.
- Amendment to the Companies Act, 2013 so that at the time of sanctioning a scheme of revival creditors within the same class are treated equally; and dissenting creditors receive as much as they would in liquidation.
- An administrative mechanism for resolving financial distress of viable MSMEs through 'Committees for Distressed Micro, Small and Medium Enterprises' to be established by banks by amending the Micro, Small and Medium Enterprises Development Act, 2006.
- Bankruptcy codes in the US and the UK provide for an automatic/ interim moratorium on the enforcement of claims upon filing for bankruptcy. However, in view of problems with an automatic moratorium under SICA, it is proposed to retain the present provisions in the Companies Act, 2013, while stipulating clear principles regarding exercise of discretion by NCLT on grant of moratorium or not.

BLRC has provided a comprehensive and improvised framework for strengthening the bankruptcy procedures in India. This will result in considerable improvement in the credit climate in the country.

Reference:

Government of India (2015), 'Interim Report of The Bankruptcy Law Reform Committee', Ministry of Finance.

2015, Bandhan Bank Limited and IDFC Bank Limited were granted license to carry out the banking business in India.

Licensing of Differentiated Banks

VI.24 Guidelines on 'Payments Banks' and 'Small Finance Banks' were issued on November 27, 2014. These banks are 'niche' or 'differentiated' banks with the common objective of furthering financial inclusion. The Reserve Bank received 72 and 41 applications for small finance banks and payments banks respectively; these are under review. So far, 11 applicants have been granted in-principle approval to set up payments banks.

New Banking Structure to Facilitate International Financial Services Centres (IFSCs)

VI.25 Pursuant to the announcement of Government of India on setting up of an IFSC in Gujarat International Finance Tech-City (GIFT), the Reserve Bank has formulated a scheme for setting up of IFSC banking units (IBUs). This scheme will provide the financial services entities in GIFT as well as other future IFSCs with a sound supporting regulatory framework. The IBUs are expected to offer financial services to non-residents as also to residents subject to the provisions of Foreign Exchange Management Act (FEMA), 1999.

Corporate Governance

VI.26 In pursuance of the recommendations of the Committee to Review Governance of Boards of Banks in India (Chairman: Dr P. J. Nayak), set up by the Reserve Bank, guidelines were issued to banks on: fixing of upper age limit for whole time directors of private sector banks; replacing the calendar of reviews with seven key themes; and compensation for non-executive directors of private sector banks. Further, the post of chairman and managing director (CMD) has been split into an executive managing director (MD) and a non-executive chairman. The revamped process for appointment of non-executive chairmen on the boards of public sector banks (PSBs) has been initiated by the government.

KYC Norms Simplified

VI.27 KYC guidelines were revised in April 2014 to ease difficulties in opening and operating bank accounts. Accordingly, the physical presence of a customer categorised as 'low risk' is not mandatory at the time of KYC updation. Fresh proof of identity and address is not required for 'low risk' customers for updation in case of unaltered status. Self-certification of proof is allowed and banks can accept a certified copy by mail/ post; and no fresh documents are required if an existing KYC compliant customer desires to open another account in the same bank. Banks can now rely on third party due diligence at the time of account opening, provided the third party is regulated and supervised and has adequate measures in place for compliance with client due diligence.

Partial Freezing of Accounts in Case of KYC Non-Compliance

VI.28 In case of non-compliance of KYC requirements despite repeated reminders, banks should impose 'partial freezing' of such accounts in a phased manner to mitigate the threat of money laundering and financing of terrorism. If the account is still KYC non-compliant after six months of 'partial freezing', banks may render it inoperative. The account can be revived on submission of KYC documents.

Deposit Callability, Sole Criteria for Differential Rates

VI.29 Effective April 16, 2015, banks are allowed to offer differential rates of interest on term deposits on the basis of tenor and premature-withdrawal facility for deposits of less than ₹10 million and on the basis of quantum, tenor and premature-withdrawal facility for deposits of ₹10 million and above, subject to certain conditions. However, all term deposits of individuals (held singly or jointly) of ₹1.5 million and below should, necessarily have premature withdrawal facility.

Rationalisation of Penal Charges

VI.30 From April 1, 2015, banks are required to notify a customer by SMS/ email/ letter before applying penal charges for non-maintenance of minimum balance in the inoperative savings account. Furthermore, penal charges have to be

directly proportional to the extent of shortfall observed and levied after one month from the date of notice to a customer.

Distribution of Insurance Products

VI.31 Detailed customer protection guidelines were issued to banks conducting insurance distribution activities, *e.g.,* ensuring customer suitability while selling an insurance product only when the customer volunteers to purchase it, prohibiting payment of commission/ incentive directly to the staff, transparency in disclosure of brokerage/ fee earned from the insurer, adherence to KYC guidelines and requirement of having a robust grievance redressal mechanism.

Agenda for 2015-16

VI.32 In continuation of the stance that guided regulatory actions in 2014-15, it is proposed to implement the final framework for the LE regime and for NSFR in the ensuing year. Besides, the Reserve Bank will be issuing draft guidelines for consultation on counterparty credit risk exposures, Pillar 3 disclosures and the securitisation framework. These regulations will reflect the revised BCBS norms in the respective areas.

VI.33 The Reserve Bank will also be initiating suitable measures towards convergence of accounting standards with the International Financial Reporting Standards (IFRS). In-principle approvals will be issued to suitable applicants for setting up of Small Finance Banks/ Payments Banks while the regulatory framework for them will be formulated. On the future of local area banks (LABs), a consultation process will be initiated while draft guidelines for on tap licensing of universal banks will be framed.

VI.34 Implementation of certain major recommendations of the Nayak Committee regarding governance reforms in PSBs, including remuneration and professionalisation of the boards will be taken forward. For more effective monetary transmission, banks will be encouraged to move in a time-bound manner to a marginal cost of funds-based determination of their base rates. It is further proposed to examine the current framework on presence of foreign banks in India in line with emerging international developments as well as the experience gained so far. To add additional clarity, frequently asked questions (FAQs) will be issued on various aspects of the wholly owned subsidiary framework issued in November 2013. Guidelines will also be framed on ownership in private sector banks which will include raising the ceiling on voting rights from 10 to 15 per cent.

Cooperative Banks: Department of Cooperative Bank Regulation (DCBR)

VI.35 As UCBs play an important role in the Indian financial system, the Reserve Bank has always endeavoured to strengthen the regulatory and supervisory framework so that they emerge financially strong and have sound governance. DCBR plays the lead role in framing regulations for UCBs apart from State Cooperative Banks (StCBs) and District Central Cooperative Banks (DCCBs).

Agenda for 2014-15: Implementation Status

VI.36 The agenda of DCBR for 2014-15 focused on putting in place a revised supervisory action framework, pursuing legal/ regulatory amendments to facilitate conversion of UCBs into commercial banks and also to facilitate takeover of assets and liabilities of UCBs by commercial banks. Accordingly, a revised supervisory action framework was put in place in 2014-15. As regards legal amendments to facilitate conversion of UCBs into commercial banks, while the Companies Act, 2013 has enabling provisions there is need for

corresponding provisions in the Multi State Cooperative Societies Act, which have been taken up with the government. With regard to commercial banks taking over assets and liabilities of UCBs, necessary tweaking of the regulations was accomplished during the year. This enables commercial banks to complete the effort on a fair price basis. The other important achievements during the year were:

Reserve Requirements

VI.37 Cash reserve ratio (CRR) requirements for non-scheduled UCBs and statutory liquidity ratio (SLR) requirements for all UCBs have been aligned with those of commercial banks following the Banking Laws (Amendment) Act, 2012 coming into force. Accordingly, UCBs were required to comply with the stipulated SLR by March 31, 2015. Balances with StCBs/ DCCBs and term deposits with PSBs are not eligible to be reckoned for SLR with effect from April 1, 2015. StCBs and DCCBs were also required to maintain SLR only in the form of approved securities from April 1, 2015. On a review, they have been allowed to shift their SLR term deposits to approved securities in phases by March 31, 2017.

Liquidity Adjustment Facility (LAF) Extended to Scheduled UCBs

VI.38 With a view to providing an additional avenue for liquidity management, LAF has been extended from November 28, 2014 to scheduled UCBs that are core banking solution (CBS)-enabled, have capital to risk-weighted assets ratio (CRAR) of at least 9 per cent and are fully compliant with the eligibility criteria prescribed for LAF.

Technology Adoption

VI.39 In order to integrate with the financial system and to improve regulatory reporting, UCBs were advised to implement CBS by December 31, 2014. At end-June 2015, 1,040 of the 1,577 UCBs had implemented CBS. Implementation of CBS has been prescribed as an additional criterion for being considered as financially sound and well managed (FSWM) bank, a criterion applied for extending various regulatory approvals to UCBs, including opening new branches. In order to bring in transparency and objectivity, 'regulatory comfort', an important aspect considered for classifying a bank as FSWM, has been redefined to include compliance with standard regulatory provisions during the last two financial years.

VI.40 FSWM UCBs are allowed to offer internet banking (view only) facilities to their customers provided they have migrated to the Internet Protocol Version 6 (IPv6). They can also open on-site/ off-site/ mobile automated teller machines (ATMs) without prior approval of the Reserve Bank provided they have a minimum net worth of ₹0.5 billion.

VI.41 Similarly, with a view to providing greater freedom to StCBs to expand their business and to provide technology-enabled services to their customers, StCBs can also open off-site/ mobile ATMs without prior approval of the Reserve Bank subject to certain prescribed criteria. These initiatives are aimed at bringing cooperative banks on par with commercial banks.

Supervisory Action Framework for UCBs

VI.42 As indicated in the last Annual Report, trigger points necessitating supervisory/ regulatory action have been revised for UCBs for early identification of stress and its rectification. UCBs are required to go for corrective action if the gross non-performing assets (NPAs) to advances ratio exceeds 10 per cent or they experience an incremental gross NPA ratio of 3 percentage points each during the last two consecutive years, whichever is earlier. Other triggers for corrective actions include regulatory capital falling below 9 per cent, incurring losses for two consecutive years and the credit deposit ratio exceeding 70 per cent.

VI.43 UCBs have been advised to constitute special committee of the board for monitoring and following up cases of frauds involving amounts of ₹10 million and above exclusively. The Audit Committee of Board (ACB) will continue to monitor all the cases of frauds, in general. UCBs have also been advised to become members of all the four credit information companies (CICs), and furnish historical data to them with a view to enhancing accuracy of the credit information.

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VI.44 A High Powered Committee for UCBs (Chairman: Shri R Gandhi) constituted, *inter alia,* to examine and recommend an appropriate set of businesses, size, conversion and licensing terms for UCBs has since submitted its report. The recommendations of the committee will be considered for implementation during the year. The Reserve Bank will also initiate measures to improve the quality of statutory audits in UCBs during the year. The process of harmonisation of regulation of UCBs and Rural Cooperative Banks will be continued.

NBFCs: Department of Non-Banking Regulation (DNBR)

VI.45 The regulation of the NBFC sector is guided by the need to foster additional credit delivery channels while preserving financial stability. DNBR which was carved out of the erstwhile Department of Non-Banking Supervision (DNBS) is the nodal department for regulation of NBFCs, including stand-alone primary dealers (PDs). Keeping in view the role of shadow banking activities in intensifying the global financial crisis as also the rising role of NBFCs domestically, the Reserve Bank's focus during 2014-15 was on addressing gaps in regulation of NBFCs and harmonising regulations to enable delivery of innovation and last mile connectivity in credit. Further, in the light of significant progress made by NBFC-MFIs following the crisis in then Andhra Pradesh in 2008-09, a comprehensive review of their regulation was also completed during the year.

Agenda for 2014-15: Implementation Status

Review of the Regulatory Framework for NBFCs

VI.46 The NBFC sector has evolved considerably in terms of its size, operations, technological sophistication and entry into newer areas of financial services and products. Accordingly, the entire regulatory framework for the sector was reviewed with a view to transitioning, over time, to an activity-based regulation of NBFCs while ensuring that NBFCs having lower risk profiles will be lightly regulated (Box VI.3).

Aligning NBFC Regulation

VI.47 Aligning regulation of the non-banking financial sector with that of the banking sector not only fosters competition but also helps lower regulatory arbitrage and contain a possible build-up of systemic risks outside the banking system. Accordingly, a number of regulatory initiatives were undertaken covering lending by NBFCs against shares, restructuring of advances, structuring of long term project loans to infrastructure and core industries, levy of foreclosure charges and private placement of non-convertible debentures.

*Shadow Banking Implementation Group (*SBIG*)*

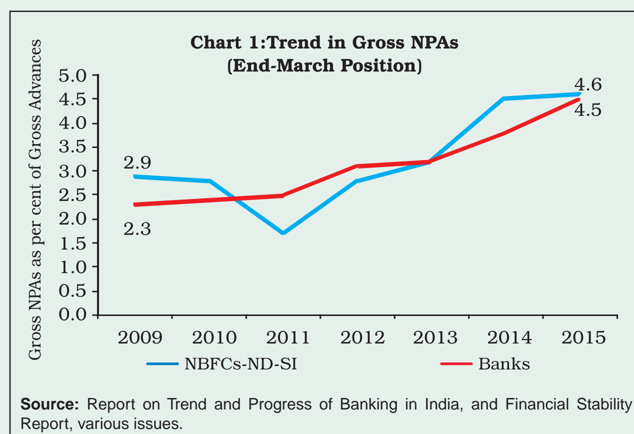
VI.48 In line with the Financial Stability Board's (FSB) approach to shadow banking activities, a preliminary inter-regulatory study was conducted to identify the nature of non-bank credit intermediation in India. Accordingly, a SBIG has been formed to assess the level of regulatory compliance *vis-a-vis* FSB guidelines and recommend possible approaches for implementation of reforms. SBIG is expected to submit its report shortly.

Box VI.3
Asset Quality of NBFCs and Revised Guidelines

In recent years, asset quality of the systemically important non-deposit taking NBFCs (NBFCs-ND-SI) has gone through the vicissitudes of overall deterioration spreading across the financial system as the economy slowed. Their gross NPAs as per cent of credit deployed rose to 4.6 per cent by end-March 2015 (Chart 1).

With a view to strengthening the early warning system for recognising incipient financial stress, NBFCs were directed in March 2014 to create a sub-asset category 'Special Mention Accounts' (SMAs). They were also directed to report relevant credit information to the Central Repository of Information on Large Credits (CRILC).The scheme for encouraging banks to extend long-term loans (known as the 5/ 25 structure) to infrastructure with a flexible structuring/ tenure to absorb potential adverse contingencies has also been extended to NBFCs from January 2015.

The revised regulatory framework for NBFCs issued in November 2014 aligns NPA norms for NBFCs with that of banks in a phased manner. Accordingly, the time limit for classifying a loan account as NPA will be progressively reduced to 90 days by March 2018. Furthermore, to bring parity in the regulation of NBFCs with other financial institutions (FIs) in matters relating to recovery of bad loans, NBFCs registered with the Reserve Bank and having asset size of ₹5 billion and above will be considered for notification as FIs in terms of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002.



Source: Report on Trend and Progress of Banking in India, and Financial Stability Report, various issues.

Other key changes to the regulatory framework include:

- All existing NBFCs (those registered prior to April 1999) need to attain net owned funds (NOFs) of minimum ₹20 million in a phased manner by end-March 2017, with failure resulting in cancellation of their Certificates of Registration.
- Only NBFCs with the minimum investment grade credit rating can accept deposits. Existing unrated Asset Finance Companies (AFCs) need to be rated by end-March 2016. Further, the limit for acceptance of deposits has been harmonised to 1.5 times the NOF across all deposit-taking NBFCs (NBFCs-D).
- The threshold for defining systemic significance for non-deposit taking NBFCs (NBFCs-ND-SI) has been revised to ₹5 billion.
- NBFCs-NDs have been exempted from the requirement of CRAR and credit concentration norms.
- Tighter prudential norms have been prescribed for NBFCs-ND-SI and all NBFCs-D in a phased manner - minimum Tier 1 capital requirement to be increased from 7.5 to 10 per cent (by end-March 2017), provision for standard assets to be increased to 0.4 per cent (by end-March 2018) and dispensation of 5 per cent given to AFCs from the prescribed credit concentration norms have been done away with.

Additional corporate governance standards and disclosure norms for NBFCs have been issued to all NBFCs-D and those NBFCs-ND-SI with an asset size over ₹5 billion. Accordingly, these NBFCs need to create various committees for audit, risk management and for nomination of directors based on fit and proper criteria. They also need to frame internal board-approved corporate governance guidelines and make them public on their websites.

References:

Reserve Bank of India (2014), 'Early Recognition of Financial Distress, Prompt Steps for Resolution and Fair Recovery for Lenders: Framework for Revitalising Distressed Assets in the Economy', March.

——— (2014), 'Revised Regulatory Framework for NBFCs', November.

——— (2015), 'Flexible Structuring of Long Term Project Loans to Infrastructure and Core Industries', January.

MUDRA Limited

VI.49 In line with the announcement in Union Budget, 2015-16, a Micro Units Development Refinance Agency (MUDRA) Ltd. was established on March 18, 2015 for regulating and refinancing MFIs (Box VI.4).

Box VI.4
Micro Units Development Refinance Agency (MUDRA) Ltd.

Union Budget, 2015-16 announced the establishment of MUDRA Ltd. that will be responsible for both regulating and refinancing all micro-finance institutions (MFIs) which are in the business of lending to micro/ small business entities engaged in manufacturing, trading and service activities and also partner with state level/ regional level coordinators to provide finance to last mile financers of small/ micro business enterprises. The government will allocate a sum of ₹200 billion to MUDRA from the shortfall in priority sector lending for creating a refinance fund to provide refinance to last mile financers. Another ₹300 billion will be provided to MUDRA from the Budget to create a credit guarantee corpus for guaranteeing loans provided to micro-enterprises.

Appropriate legislation is being drafted by the central government for setting up MUDRA. Pending legislative approval, MUDRA Ltd. was incorporated on March 18, 2015, under the Companies Act, 2013, as a wholly owned subsidiary of the Small Industries Development Bank of India (SIDBI) to carry out activities relating to development and financing of small micro-enterprises, and was registered with the Reserve Bank as a non-deposit taking NBFC on April 6, 2015. SIDBI has been exempted for its proposed investment of ₹7.5 billion in MUDRA from the cross-holding of capital among banks/ FIs.

Agenda for 2015-16

VI.50 The process of regulatory convergence between banks and non-banks will be taken forward in 2015-16. Further, activity based regulation is envisaged for the sector, thereby doing away with multiple categories of NBFCs. As a first step, NBFCs are being progressively classified into two broad heads - core investment companies and non - core investment companies. In addition, government owned NBFCs are being brought in within the regulatory ambit of the Reserve Bank.

SUPERVISION OF FINANCIAL INTERMEDIARIES

Commercial Banks: Department of Banking Supervision (DBS)

VI.51 DBS is entrusted with the supervisory responsibility of commercial banks, and aims at designing and implementing policies and strategies for supervision to develop a safe and efficient banking system. In this endeavour, managerial practices in banks and All India Financial Institutions (AIFIs) that strengthen their corporate governance and internal controls are also encouraged. DBS also functions as the secretariat to the Inter Regulatory Forum set up under the aegis of the sub-committee of FSDC for oversight of identified financial conglomerates (FCs) in coordination with other domestic regulators.

Agenda for 2014-15: Implementation Status

Risk Based Supervision (RBS) and Capacity Building

VI.52 The Reserve Bank is moving progressively from a performance based CAMELS (capital adequacy, asset quality, management, earning, liquidity and system and control) framework to a forward looking RBS framework for early detection of risks, timely and appropriate supervisory interventions and more generally for improving the quality of supervisory processes in line with global best practices. Two more banks were brought under RBS in 2014-15, taking the total to 30 major banks. Six more banks have been migrated to RBS framework from 2015-16 assessment cycle. The RBS model was also optimised, fine-tuning data collection from commercial banks. The need for preparedness at the banks' level, including a robust management information system for RBS was highlighted.

Oversight of Financial Conglomerates (FCs)

VI.53 The Reserve Bank, in coordination with other domestic regulators, concluded discussion

meetings with two bank-led FCs and participated in a discussion meeting of one insurance company-led FC organised by Insurance Regulatory Development Authority (IRDA), to review group level and inter-regulatory issues in the operations of these FCs.

Early Warning System (EWS) *and Prompt Corrective Action (PCA)*

VI.54 A framework on EWS to track deviation of critical financial indicators triggering granular investigations has since been finalised and its details are being worked out. Alongside, the existing PCA framework for banks, first introduced in 2002 is being revamped. This will subsequently be extended to FCs in coordination with other domestic regulators.

Global Supervisory Cooperation

VI.55 As part of cross-border supervisory cooperation and exchange of information, the Reserve Bank signed MoUs with six overseas banking supervisory authorities in 2014-15 - Hong Kong Monetary Authority; Central Bank of Kenya; Banco Central do Brasil; Bank of Uganda; Central Bank of Seychelles and Maldives Monetary Authority. A statement of cooperation with three US financial regulators, *viz.,* Board of Governors of the Federal Reserve System, Office of the Comptroller of Currency and Federal Deposits Insurance Corporation has also been established. Till date, the Reserve Bank has executed 26 MoUs, one letter for supervisory cooperation and one statement of cooperation with overseas supervisors/ regulators.

VI.56 In line with the BCBS principles on cross-border consolidated supervision, the Reserve Bank is instituting supervisory colleges for Indian banks with considerable overseas presence. Supervisory colleges have been set up for State Bank of India, ICICI Bank Ltd., Bank of Baroda, Bank of India, Punjab National Bank and Axis Bank Ltd.

Agenda for 2015-16

VI.57 Going forward, all small foreign banks operating in India are set to be brought into RBS. While a new format is being devised for inspection of the AIFIs - National Bank for Agriculture and Rural Development (NABARD), SIDBI, Export-Import (EXIM) Bank of India and the National Housing Bank (NHB), the revised format for CRILC reporting, including improved analytics is expected to be rolled out soon. In coordination with the IRDA, it is proposed to collect CRILC data from insurance companies as well.

VI.58 All Off-site Monitoring and Surveillance System (OSMOS) returns are planned to migrate to an eXtensible Business Reporting Language (XBRL)/ data warehouse environment towards developing a single information system for supervisory purposes. A new framework for fraud detection, reporting and monitoring has been rolled out on May 7, 2015. Further, a central fraud registry for use by banks is also under preparation. Though disparate systems used by the regulated entities hinder the process of automated data flow, the Reserve Bank will continue to encourage banks to switch over to entirely automated modes of data submission.

VI.59 Capacity building, with particular focus on RBS processes, system audit and information technology vulnerability/ penetration testing, is planned to be rolled out in 2015-16. The EWS as well as the revamped PCA framework for banks are likely to be finalised in 2015-16. Work relating to developing a PCA framework for FCs is expected to be initiated in coordination with other domestic regulators. The Reserve Bank is also exploring ways, including appropriate penal measures towards improving the compliance culture amongst regulated entities.

Cooperative Banks: Department of Cooperative Bank Supervision (DCBS)

VI.60 DCBS was carved out of the erstwhile Urban Banks Department (UBD) and it is primarily focused on ensuring the financial soundness of individual UCBs as well as the sector as a whole.

Agenda for 2014-15: Implementation Status

VI.61 During the year, 968 UCBs, comprising all scheduled UCBs, C and D rated non-scheduled UCBs, and A and B rated non-scheduled UCBs due for inspection, were subjected to on-site inspections and appropriate supervisory action. While the licences of nine UCBs were cancelled, two UCBs were merged with other UCBs and 'All Inclusive Directions' were imposed on seven UCBs. All the 1,589 UCBs were supervised through off-site surveillance system. Towards developing a single point platform for data collection, processing and dissemination, 13 returns for UCBs have been migrated to the XBRL-based reporting system from the existing off-site surveillance reporting system. Training programmes to improve professionalism and governance in UCBs were also organised by the Reserve Bank.

Agenda for 2015-16

VI.62 While ensuring effective supervision of UCBs, further reduction in the number of UCBs with negative net worth has been envisaged for 2015-16. The migration of all the returns to the XBRL-based reporting platform will be completed in the coming year. The initiatives for capacity building in the UCB sector will be carried forward in the coming year too.

NBFCs: Department of Non-Banking Supervision (DNBS)

VI.63 This department is the supervisory wing of NBFCs and it aims at establishing an enabling environment for a healthy and sound NBFC sector while protecting the interests of depositors, customers and other stakeholders as also safeguarding the country's financial system from contagion risks out of this sector. The department also endeavours to increase public awareness on the legal/ regulatory framework for entities engaged in various types of financial activities.

Agenda for 2014-15: Implementation Status

VI.64 Deposit taking and systemically important' non-deposit taking NBFCs continued to be the focus of on-site inspections. During 2014-15, 72 deposit taking companies and 182 non-deposit taking companies were inspected. To deal with delinquent and unauthorised entities, SLCCs were reconstituted in May 2014 with the Chief Secretary to the State Government as the Chairman and the Reserve Bank as the secretariat to facilitate regular sharing of market intelligence (MI) and taking coordinated timely action. The Reserve Bank also hosted two conferences of Chief Secretaries/ Administrators of the states/ union territories (UTs) during the year to deliberate on issues concerning fund mobilisations by unauthorised entities. MI cells were also created across 16 regional offices of the Reserve Bank.

Securitisation/ Asset Reconstruction

VI.65 Asset Reconstruction Companies (ARCs) have been steadily increasing their presence in the debt recovery process (Table VI.1). At the end of March 2015, there were 15 securitisation companies (SCs)/ reconstruction companies (RCs) registered with the Reserve Bank. At end-March 2015, the book value of assets acquired by the ARCs stood at around ₹508 billion. While the ARCs are already under off-site surveillance, they will be supervised through on-site inspections in the coming year in view of their increasing importance.

Agenda for 2015-16

VI.66 Small NBFCs which have so far been exempted from regulatory returns will be covered

Table VI.1: Key Financial Parameters for the ARC Sector

(₹ billion)

Item	Mar-14	Mar-15
1	2	3
Owned Fund	30.2	34.0
Acquisition cost of the assets acquired by the SC/ RC	205.8	226.6
Total SRs issued	204.1	224.4
SRs held by SC/ RC in its own account	13.8	29.9
SRs held by seller banks/ FIs	187.6	191.6
Amount of SRs issued to other QIBs	2.4	2.9
SRs held by FIIs	0.2	0.0
SRs redeemed (during the year)	11.9	16.5

SR: Security Receipts; QIBs: Qualified Institutional Buyers; FIIs: Foreign Institutional Investors
Source: COSMOS returns (quarterly).

under off-site monitoring in 2015-16. For dissemination of information amongst SLCC members/ general public, a dedicated website will be launched in the coming year. CRILC information on large borrowers from NBFCs will be taken up for analysis once the platform is fully operationalised. The consultative approach followed by the department is proposed to be formalised to having periodical interactions with the industry in 2015-16.

Deposit Insurance and Credit Guarantee Corporation (DICGC)

VI.67 Deposit insurance extended by DICGC, a wholly-owned subsidiary of the Reserve Bank, covers all banks including LABs, regional rural banks (RRBs) and cooperative banks in the country. As per the International Association of Deposit Insurers' (IADI) Core Principles for Effective Deposit Insurance System 2014, deposit insurance coverage should be limited, credible and cover a large majority of depositors but leave a substantial amount of deposits exposed to market discipline. The current limit of deposit insurance is ₹0.1 million per depositor in the same right and same capacity. As on March 31, 2015, 92.3 per cent of the accounts were fully protected. Amount-wise, insured deposits at ₹26.1 trillion constituted nearly 31 per cent of the assessable deposits. An effective deposit insurance design should be capable of managing its risk by seeking compensation for the risks being transferred to it. Hence, risk-based collection of premium could be an important step in this direction (Box VI.5).

VI.68 During 2014-15, aggregate claims for ₹3.2 billion with respect to 30 cooperative banks taken

Box VI.5
Risk-based Premium for Banks

Deposit insurance can create an incentive for banks to choose high leverage and for customers of banks to be lenient on monitoring. In order to deal with this kind of moral hazard, the premium of deposit insurance should properly reflect the effective underlying risk associated with a bank's activities. It could be partially mitigated by introducing risk-adjusted premium for a deposit insurance scheme. Although a flat-rate premium system has the advantage of being relatively easy to understand and administer, it does not take into account the level of risk that a bank poses to the deposit insurance system and can be perceived as unfair in terms of premium rate and risk profile across banks (IADI 2011).

Literature on deposit insurance identifies two different approaches for determining risk-based premium. The expected loss pricing approach is centred on the expected default probability of a bank, which can be estimated using either fundamentals, rating or market analysis. The Merton type approach uses option pricing theory in order to estimate the probability of default by a company.

In practice, risk-based contributions are defined in terms of a contribution base, adjusted for a factor that is proportional to the risk attitude of the members and a factor reflecting the overall conditions in the banking system in the respective country (Walter and Schaller, 2012). The premium assessment can be summarised in a simple risk function:

$$P_{it} = r_{s,t} * r_{it} * D_{it}$$

where, the bank-specific risk-based contribution (P_{it}) consists of size and risk variables and is defined in terms of a contribution base ($D_{i,t}$), usually the total amount of eligible deposits, plus or minus a percentage ($r_{i,t}$) proportional to the risk attitude of a member (specific risk) and a percentage (r_{st}) reflecting the overall conditions in the banking system in the country (systemic risk).

(Contd....)

The practice in the European Union (EU) suggests that key financial ratios currently applied in assessment of a member institution's risk across member states are quite heterogeneous and the variables taken into account to define them are not identical. The 2014 EU Directive on Deposit Insurance Schemes gives only broad guidance for a risk measure but leaves the fine details to the wisdom of member states. In the US, new rules for risk-based assessment were issued in November 2006 and significant refinements were made to risk-related premium pursuant to financial reform legislation enacted in 2010. For small banks, supervisory CAMELS ratings are combined with financial ratios to determine risk-based assessment rates against deposits. For large banks, in 2011, the US Federal Deposit Insurance Corporation (FDIC) adopted a risk differentiation scheme that combines CAMELS rating and forward looking financial measures of risk.

In India, there have been periodic recommendations for the application of risk-based premium for banks. The Narasimham Committee Report on Banking Sector Reforms (1998), while focusing on structural issues recommended introduction of a risk-based premium system in lieu of the flat-rate premium system. This view was echoed by the Reserve Bank's Capoor Committee on Reforms in Deposit Insurance in India (1999). The Committee on Credit Risk Model (2006) constituted by DICGC also recommended the introduction of risk-based premium, to begin with for SCBs and UCBs.

Notwithstanding the recommendations of various committees in the past, the implementation of risk-based premium could not be operationalised, *inter alia*, due to cooperative banks and RRBs (forming over 90 per cent of insured banks) being under restructuring until recently and lack of a robust supervisory rating for all insured banks, especially cooperative banks which serves as an important input for the rating model. However, there has been a persistent demand from stakeholders and public representatives for a hike in the deposit insurance cover from the current level of ₹0.1 million. A hike in cover without calibrating premium rates to the risk profiles of insured banks covered only exacerbates the risks of an inherent moral hazard. Keeping this in view, a Committee on Differential Premium for Banks (Chairman: Shri Jasbir Singh) was constituted in March 2015 to make recommendations for the introduction of risk-based premium in India.

References:

International Association of Deposit Insurers (IADI) (2011), 'General Guidance for Developing Differential Premium Systems'.

Walter and Schaller (2012), 'An Alternative Way of Calculating Risk Based Premium' in New Paradigms in Banking, Financial Markets and Regulation? ed Balling et al., SUERF.

European Commission (2008), 'Risk-based Contributions in EU Deposit Guarantee Schemes: Current Practices', Joint Research Centre.

into liquidation/ reconstruction/ amalgamation were settled as compared to ₹1.0 billion in the previous year. The size of the deposit insurance fund (DIF) stood at ₹504.5 billion as at end-March 2015, yielding a reserve ratio (DIF/ insured deposits) of 1.9 per cent.

National Housing Bank (NHB)

VI.69 NHB, a wholly owned subsidiary of the Reserve Bank, was set up on July 9, 1988, under the National Housing Bank Act, 1987, to operate as a principal agency to promote housing finance institutions both at local and regional levels and to provide financial and other support incidental to such institutions.

VI.70 As the apex institution for housing finance, NHB registers, regulates and supervises housing finance companies (HFCs). As on June 30, 2015, there were 65 HFCs registered with NHB. NHB is focused on promoting innovative market based solutions for affordable housing finance to low income housing segments. NHB extends refinance to HFC, scheduled commercial banks (SCBs) and cooperative sector institutions, against their housing loans. It also provides project lending to a range of borrowers in public and public-private partnerships, MFIs, state level housing boards and area development authorities for large scale integrated housing projects and slum redevelopment projects. The cumulative disbursements in 2014-15 stood around ₹218.5 billion of which 25.4 per cent (₹55.4 billion) was made for rural housing loans under the Rural Housing Fund (RHF) and the Golden Jubilee Rural Housing Refinance Scheme (GJRHRS).

VI.71 The government has identified NHB as one of the central nodal agencies to channelise subsidy to lending institutions and monitoring the progress of the component under the Credit Linked Subsidy Scheme (CLSS). CLSS will be implemented across the country in all 4,041 statutory towns (as per Census 2011) and is part of the Pradhan Mantri Awas Yojana - Housing for All (HFA) mission, which seeks to address the housing requirements of urban poor, including of slum dwellers. NHB has also been a nodal agency for government schemes, such as the Interest Subsidy Scheme for Housing the Urban Poor (ISHUP), 1 per cent Interest Subvention scheme and the Solar Capital Subsidy scheme.

VI.72 NHB also manages the Credit Risk Guarantee Fund Trust for low income housing set up by the Government of India to ensure better flow of institutional credit for housing in urban areas. NHB launched RESIDEX in July 2007 for tracking residential property prices across 26 cities in India on a quarterly basis. The central government enhanced allocations for NHB from ₹40 billion to ₹80 billion in 2014-15 to expand and support rural housing in the country.

CONSUMER EDUCATION AND PROTECTION

Consumer Education and Protection Department (CEPD)

VI.73 CEPD focuses on pursuing public interest, providing a level playing field between suppliers and consumers of financial services by reducing the imbalances emanating from information asymmetries, limited product choices, inadequate disclosures, *etc.* Consumer protection is a key to promoting financial inclusion.

Agenda for 2014-15: Implementation Status

Charter of Customer Rights

VI.74 As a structured measure towards protection of bank customers and setting standards of customer service, a Charter of Customer Rights as broad, over-arching principles for protecting bank customers was formulated by the Reserve Bank in 2014-15 (Box VI.6). The Indian Banks' Association (IBA) and Banking Codes and Standards Board of India (BCSBI) have since jointly formulated a model customer rights policy/

Box VI.6
Charter of Customer Rights

The Charter of Customer Rights released on December 3, 2014, enshrines broad, over-arching principles for protection of bank customers and enunciates five basic rights for bank customers as:

(i) *Right to Fair Treatment:* Both the customer and the financial services provider have a right to be treated with courtesy. The customer should not be unfairly discriminated against on grounds such as gender, age, religion, caste and physical ability when offering and delivering financial products.

(ii) *Right to Transparency, Fair and Honest Dealing:* The financial services provider should make every effort to ensure that the contracts or agreements it frames are transparent, easily understood and well communicated to the common person. The product's price, associated risks, customer's responsibilities and the terms and conditions that govern its use over the product's life-cycle, should be clearly disclosed. The customer should not be subject to unfair business or marketing practices, coercive contractual terms or misleading representations. Over the course of their relationship, the financial services provider cannot threaten the customer with physical harm, exert undue influence or engage in blatant harassment.

(iii) *Right to Suitability:* The products offered should be appropriate to the needs of the customer and based on an assessment of the customer's financial circumstances and understanding.

(iv) *Right to Privacy:* Customers' personal information should be kept confidential unless they have offered specific consent to the financial services provider or such information is required to be provided under the law or it is provided for a mandated business purpose

(Contd....)

(for example, to credit information companies). The customer should be informed upfront about likely mandated business purposes. Customers have the right to protection from all kinds of communications, electronic or otherwise, which infringe upon their privacy.

(v) *Right to Grievance Redress and Compensation:* The customer has a right to hold the financial services provider accountable for the products offered and to have a clear and easy way to have any valid grievances redressed. The provider should also facilitate the redress of grievances stemming from the sale of third party products. The financial services provider must communicate its compensation policy for mistakes, lapses in conduct, as well as non-performance or delays in performance, whether caused by the provider or otherwise. The policy must lay out the rights and duties of the customer when such events occur.

These rights aim to protect the customer against unfair discrimination, unfair business or marketing practices, coercive contractual terms or misleading representations and aim to promote appropriate need warranted financial products with a better understanding of the various risks and charges involved therein.

code based on the Charter of Customer Rights. Banks were advised to formulate board approved customer rights policies by July 31, 2015 incorporating the Charter of Customer Rights, and periodically review its implementation internally.

Internal Ombudsman in Banks

VI.75 For strengthening the grievance redressal mechanism available to bank customers, all PSBs, select private sector and foreign banks were advised to appoint Chief Customer Service Officers as Internal Ombudsman in banks who should examine complaints, which remained unresolved/ partially resolved by the internal grievance redressal mechanism of the bank.

Ascertaining Field Level Feedback and Enhancing Awareness

VI.76 For initiating appropriate corrective action, incognito visits of select bank branches were undertaken to ascertain field level feedback on complaints regarding mis-selling of third party products by banks like insurance and mutual funds. The feedback received was forwarded to all stakeholders. Further, in view of the large number of complaints on fictitious offers of money, public awareness campaigns about such fictitious offers, including the availability of the Banking Ombudsman (BO) scheme were conducted, particularly in rural and semi-urban areas.

Agenda for 2015-16

VI.77 The Reserve Bank will focus on full-fledged operationalisation of the Charter of Customer Rights in banks. The BO scheme is also being taken up for a complete review in 2015-16. Focused field visits/ study on mis-selling by banks in semi-urban areas and non-functioning/ mal-functioning ATMs across various parts of the country have also been planned.