V FINANCIAL MARKETS AND FOREIGN EXCHANGE MANAGEMENT

The Reserve Bank ensured orderly financial market conditions, despite formidable global headwinds during the year. It sustained efforts to develop and deepen various segments of the financial markets by strengthening the regulatory framework aimed at broadening participation, easing access and fostering product innovation. Measures to enhance the ease of doing business and lower the compliance burden were the outcome of a process of constant review and rationalisation of various regulations relating to foreign exchange. Liquidity operations were proactively aligned to the shift in the stance of monetary policy.

V.1 During 2022-23, the Reserve Bank continued to unveil new regulatory initiatives, both proactively and in response to evolving challenges, to further develop financial markets in terms of easing access, broadening participation, reducing compliance burden and enhancing market transparency. Targeted measures against unauthorised forex trading platforms were introduced taking cognisance of the risks to financial stability. The liquidity management operations were conditioned by the shift in the stance of monetary policy, *i.e.,* gradual withdrawal of accommodation in a tightening cycle of the policy repo rate. The Reserve Bank also facilitated external trade and payments and promoted orderly development of the foreign exchange markets, with a view to improve the ease of doing business and reduce the compliance burden through periodic review and rationalisation of procedures and ongoing efforts directed at automation of the regulatory compliance processes.

V.2 Against this backdrop, the rest of the chapter is structured into four sections. The development and regulation of financial markets are covered in section 2. The Reserve Bank's market operations are discussed in section 3. In section 4, the focus is on external trade and payments and measures relating to liberalisation and development of external financial flows. Concluding observations are set out in the last section.

2. FINANCIAL MARKETS REGULATION DEPARTMENT (FMRD)

V.3 The Financial Markets Regulation Department (FMRD) is entrusted with the development, regulation and surveillance of money, government securities (G-secs), interest rate derivatives, foreign exchange and credit derivative markets. The Department undertook several measures in pursuance of this mandate to fulfil the objectives set for 2022-23.

Agenda for 2022-23

V.4 The Department had set out the following goals for 2022-23:

- Issue directions for introducing variation margin requirements for Non-Centrally Cleared Derivatives (NCCDs) in India in the first half of 2022-23 (*Utkarsh*) [Paragraph V.5]; and
- Issue revised directions on Rupee Interest Rate Derivatives (IRD) in 2022-23, after reviewing the feedback obtained from the public with a view to allowing greater product innovation, easing non-resident access to the domestic market and rationalising procedures (Paragraph V.6).

Implementation Status

V.5 The Directions on exchange of variation margin[1] (VM) for NCCDs were issued on June 1, 2022. The Department also issued the draft Directions, mandating exchange of initial margin for NCCDs.

V.6 The Department is following a phased approach to implement the revised IRD Directions. As a first step, authorised dealer category-I (AD Cat-I) banks and standalone primary dealers (SPDs), authorised under Section 10(1) of the Foreign Exchange Management Act (FEMA), 1999 have been permitted to offer foreign currency settled – overnight indexed swap (FCS-OIS) contracts to non-residents and other eligible market-makers.

Major Initiatives

Action on Unauthorised Foreign Exchange (Forex) Trading Platforms

V.7 In view of the increasing proliferation of unauthorised trading platforms offering forex trading facilities to Indian residents, an advisory was issued cautioning the residents against undertaking forex transactions with unauthorised persons or on unauthorised electronic trading platforms (ETPs). A set of frequently asked questions (FAQs) on forex transactions in this regard was also published along with a list of authorised ETPs and an 'Alert List' of unauthorised entities understood to be offering forex trading facilities. An awareness campaign under the aegis of the 'RBI *Kehta Hai*' programme has also been initiated to create awareness about the risks involved in transacting on unauthorised trading platforms (Box V.1).

Margin Requirements for Non-Centrally Cleared Derivatives (NCCDs)

V.8 With a view to strengthening the resilience of over the counter (OTC) derivative markets and in the backdrop of the G-20 recommendations on OTC derivatives, the Master Directions – Reserve Bank of India (Variation Margin) Directions, 2022 were issued on June 1, 2022.

Box V.1
Unauthorised Forex Trading Platforms

Foreign exchange (forex) transactions in India are governed by the FEMA, 1999 and the rules, regulations, directions, and permissions issued thereunder. As per the extant statutory and regulatory framework, persons resident in India can purchase/sell forex only for permissible current and capital account transactions; and only from/to authorised persons (including recognised stock exchanges). While permitted forex transactions can be executed electronically, they should be undertaken only on electronic trading platforms authorised for the purpose by the Reserve Bank or on recognised stock exchanges as per the terms and conditions specified by the Reserve Bank from time to time.

There has been a proliferation of unauthorised ETPs in the country offering forex trading facilities to residents in recent years. These platforms are extensively advertised on news platforms, social media and digital media including search engines, over-the-top platforms and gaming apps and their misleading advertisements are often targeted at gullible customers through promises of disproportionate/exorbitant returns, bonus on initial investment and assured rewards. There have also been reports of such platforms engaging agents who personally contact prospective customers to undertake forex trading/investment schemes.

These platforms are not authorised by the Reserve Bank and the forex transactions undertaken on them are in contravention of FEMA, 1999. Such unauthorised platforms

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[1] In terms of the G20 over the counter (OTC) derivatives market reforms, OTC derivatives which are not centrally cleared should be subject to requirements for variation margin (collateral collected or paid to reflect the current mark-to-market exposure, between counterparties) and initial margin (collateral collected to cover the potential future exposure).

have the potential to attract less sophisticated customers and expose them to the risk of financial loss.

Regulatory Initiatives

Taking cognisance of this market development and growing complaints about individuals losing money and reports of frauds by these platforms, cautionary advices were issued on February 3, 2022, September 7, 2022 and February 10, 2023. Members of the public were cautioned not to undertake forex transactions on unauthorised ETPs or remit/deposit money for such unauthorised transactions. It was clarified that resident persons undertaking forex transactions for purposes other than those permitted under the FEMA or on ETPs not authorised by the Reserve Bank shall render themselves liable for legal action under the FEMA.

With a view to create greater awareness, an 'Alert List' of entities, which are neither authorised to deal in forex under the FEMA Act, 1999 nor authorised to operate ETPs for forex transactions, was published. The 'Alert List' also includes names of entities/platforms/websites which appear to be promoting unauthorised entities/ETPs, including through advertisements of such unauthorised entities or claiming to be providing training/advisory services. The 'Alert List' is not exhaustive and is based on information available with the Reserve Bank at the time of its publication. It has been clarified that an entity not appearing in the list should not be assumed to be authorised by the Reserve Bank. To ascertain the authorisation status of any person/ETP, the members of the public may refer to the list of authorised persons and the list of authorised ETPs, which have also been made available on the Reserve Bank's website. To supplement these measures, a set of FAQs on forex transactions has also been published for providing general guidance to the public.

Source: RBI.

The Directions mandate the exchange of variation margin between counterparties of non-centrally cleared OTC derivative transactions. The scope of the Directions extends to interest rate, foreign exchange and credit derivative transactions and will be applicable for financial and non-financial entities based on their outstanding transactions in OTC derivative markets.

'Fully Accessible Route' for Investment by Non-residents in Government Securities – Additional Specified Securities

V.9 The Fully Accessible Route (FAR) for non-resident investment in Central Government Securities (G-secs) introduced on March 30, 2020, permits non-residents to invest, without any macro-prudential limits, in certain specified securities (issuance of G-secs of 5-year, 10-year and 30-year). With an objective to increase the choice of G-secs available for investment by the non-resident investors under the FAR and also to augment liquidity across the sovereign yield curve, all new issuances of G-secs of 7-year and 14-year tenors (including the current issuances) were included as specified securities under the FAR on July 7, 2022. This augmentation of the FAR with the 7 and 14-year securities has been well received by the FPIs, as indicated by the build-up of the FPI holdings since July 8, 2022. In the 7-year security, the FPI holding increased from ₹118 crore before its inclusion under the FAR to ₹7,084 crore as on March 31, 2023. The 14-year security witnessed a build-up from ₹36 crore to ₹1,313 crore during the same period.

Investment by Foreign Portfolio Investors (FPI) in Debt – Relaxations

V.10 Under the Medium-Term Framework (MTF), FPI investment in government and corporate debt are subject to certain macro-prudential limits, *viz.*, (i) a short-term limit requirement wherein not more than 30 per cent of investments each in government securities and corporate bonds can have a residual maturity of less than one year, and (ii) a minimum residual maturity requirement wherein FPIs can invest only in corporate debt instruments with a residual maturity of at least one year. With an objective to enhance forex inflows while ensuring overall macroeconomic and financial stability, investments by FPIs in government securities and corporate debt were exempted on July 7, 2022 from the requirements of short-term limit and minimum residual maturity till October 31, 2022. During the above period, FPIs invested ₹3,955 crore in commercial papers (CPs).

Foreign Currency Lending by Authorised Dealer Category I (AD Cat-I) Banks

V.11 With a view to facilitate foreign currency borrowing by a larger set of borrowers who may find it difficult to directly access overseas markets, AD Cat-I banks were permitted on July 7, 2022, to utilise overseas foreign currency borrowing (OFCB) for lending in foreign currency to entities for a wider set of end-use purposes, subject to the negative list set out for external commercial borrowings (ECBs). The dispensation for raising such borrowings was available till October 31, 2022.

Permitting Standalone Primary Dealers (SPDs) to Deal in Offshore Foreign Currency Settled Rupee Derivatives Market

V.12 Banks in India were permitted in February 2022 to undertake transactions in foreign currency settled overnight indexed swap (FCS-OIS) market with non-residents and other market makers. As SPDs are also market-makers like banks in the onshore OIS market, SPDs authorised under Section 10(1) of FEMA, 1999 were permitted to undertake FCS-OIS transactions with non-residents and other eligible market-makers from August 8, 2022.

Notification of Significant Benchmark

V.13 In terms of requirements provided under the Financial Benchmark Administrators (Reserve Bank) Directions, 2019, the Reserve Bank had notified Mumbai interbank forward outright rate (MIFOR) as a 'significant benchmark'. The MIFOR is a financial benchmark comprising: (i) USD London interbank offered rate (LIBOR) and (ii) USD/INR forward premia as components. In the backdrop of beginning of cessation of LIBOR from January 1, 2022, USD LIBOR linked transactions are now permitted only for specific purposes. The MIFOR has been replaced with modified MIFOR (MMIFOR) for new financial transactions from January 1, 2022. MMIFOR comprises the adjusted secured overnight financing rate (SOFR) and the Financial Benchmarks India Private Limited (FBIL) forward premia rate. MMIFOR has been notified as a 'significant benchmark' from December 2022.

Hedging of Gold Price Risk in Overseas Markets

V.14 Resident entities in India were not permitted to hedge their exposure to gold price risk in overseas markets. With a view to providing greater flexibility to these entities to hedge the price risk of their gold exposures efficiently, resident entities have been permitted (since December 12, 2022) to hedge their gold price risk on recognised exchanges in the International Financial Services Centre (IFSC), recognised by the International Financial Services Centres Authority (IFSCA).

Inclusion of Sovereign Green Bonds under the FAR

V.15 Non-residents were permitted to invest in specified categories of G-secs without any restrictions under the FAR from April 2020. The list of specified securities under the FAR was expanded on January 23, 2023 to include all sovereign green bonds issued by the government in 2022-23.

Agenda for 2023-24

V.16 For the year 2023-24, the Department has set the following goals:

- The draft Directions mandating exchange of initial margin for NCCDs were issued for public feedback on June 16, 2022. The final Directions shall be issued in 2023-24 (*Utkarsh* 2.0);
- With a view to enhancing operational efficiencies, easing access further to the foreign exchange derivative market for users with small forex (FX) exposures and ensuring that a broader set of customers with the necessary risk management expertise are equipped with the flexibility to manage their hedging programme efficiently, the regulatory framework for hedging of FX risks will be reviewed in 2023-24; and
- With an objective to enhance market transparency, a review of the reporting and disclosure framework of trade repositories (TRs) shall be carried out in 2023-24 (*Utkarsh* 2.0).

3. FINANCIAL MARKETS OPERATIONS DEPARTMENT (FMOD)

V.17 The Financial Markets Operations Department (FMOD) is primarily responsible for the conduct of liquidity management operations in alignment with the stance of monetary policy to secure the first leg of monetary policy transmission in the financial markets and ensuring orderly conditions in the forex market through both onshore and offshore market operations.

Agenda 2022-23

V.18 During the year, the Department had set out the following goals:

- To carry out liquidity management operations effectively using all available liquidity management tools as may be necessary, in line with the stance of monetary policy (*Utkarsh*) [Paragraph V.19];
- To continue to conduct foreign exchange operations in an effective manner to curb undue volatility in the USD/INR exchange rate (Paragraph V.20-V.21); and
- To undertake policy-oriented research on financial markets (Paragraph V.22).

Implementation Status

Money Market and Liquidity Management [2]

V.19 During 2022-23, the Reserve Bank actively managed evolving liquidity in the wake of shift in the stance of monetary policy towards withdrawal of accommodation. In view of the scheduled redemption of long term repo operations (LTROs) and targeted long term repo operations (TLTROs) during February to April 2023, it remained flexible in its approach towards liquidity management. The Reserve Bank committed to conduct operations on either side of the LAF, *i.e.,* both - variable rate reverse repo (VRRR) and variable rate repo (VRR) operations, depending on the evolving liquidity conditions. The policy rate hikes, as well as the absorption of primary liquidity from the banking system through increase in the cash reserve ratio (CRR) during the year led to the weighted average call money rate (WACR) - the operating target of

[2] Details relating to liquidity management operations are covered in Chapter III of this Report.

monetary policy - increasing from 3.47 per cent in April 2022 to 6.50 per cent in March 2023.

Foreign Exchange Market

V.20 During the year, the Rupee traded with a depreciating bias tracking unrelenting appreciation of the USD in response to aggressive US Fed tightening of monetary policy and surge in US treasury yields. Elevated crude prices and FPI outflows from the domestic capital markets also exerted pressure on the Rupee. Brent crude prices averaged around US$ 95 per barrel during the financial year as against an average of around US$ 63 per barrel in the previous five years. FPI outflows, however, moderated as the US Fed slowed its pace of tightening amid signs of inflation peaking in the US.

V.21 The Reserve Bank intervened in the forex market through operations in the onshore/offshore OTC and exchange traded currency derivatives (ETCD) segments in order to maintain orderly market conditions and contain excessive volatility in the exchange rate (Box V.2).

Box V.2
Effectiveness of the Reserve Bank Measures in Containing INR Volatility

Emerging as well as advanced economy (AE) currencies witnessed heightened volatility in 2022 due to synchronised monetary policy tightening by major systemically important central banks in an effort to tame multi-decade high inflation. In particular, the US Fed's aggressive policy rate hikes led to tightening in US financial conditions. Foreign portfolio investment (FPIs) flows to EMEs turned negative reflecting risk-off sentiment, leading to sharp depreciation pressures on their exchange rates.

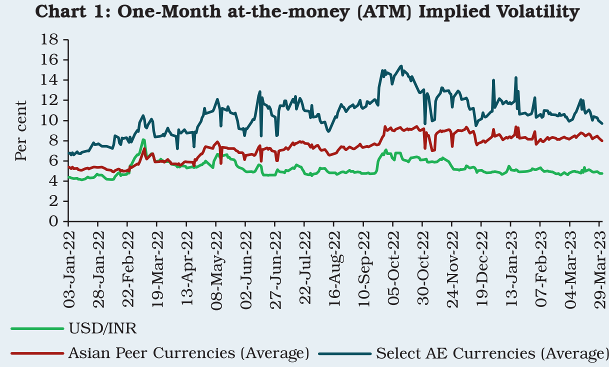
The Indian Rupee (INR) came under pressure as crude oil prices surged and equities witnessed record FPI outflows. The 1-month implied volatility of INR *vis-à-vis* USD jumped above 8.0 per cent in March 2022 for the first time since 2020, tracking Brent's surge above US$ 139 per barrel post escalation of geopolitical tensions. Domestic equities witnessed FPI outflows over nine consecutive months starting in October 2021, totalling US$ 33 billion, with June 2022 recording the second-highest monthly outflows ever of US$ 6.4 billion. Amidst these global headwinds and extreme uncertainty, the Reserve Bank intervened in the forex market to contain INR volatility without reference to any specific level or band of the exchange rate, besides undertaking various other policy measures.

The implied volatility of USD/INR was largely contained during January 2022 to March 2023 following the Reserve Bank's intervention measures and it remained well below the average implied volatilities of major Asian peers[3] and select AE currencies[4] during this period (Chart 1).

To assess the effectiveness of the Reserve Bank's intervention in reducing Indian Rupee's volatility, a generalised autoregressive conditional heteroscedasticity (GARCH) model has been applied on select variables for the sample period April 2022 to March 2023. Here, the dependent variable, lnr_t, is log difference of closing USD/INR spot exchange rate (S) over two consecutive days, indicating return on the exchange rate.

$$lnr_t = 100 \times (\ln S_t - \ln S_{t-1}) \qquad \text{...(1)}$$

Chart 1: One-Month at-the-money (ATM) Implied Volatility



Source: Bloomberg.

(Contd.)

[3] Chinese Yuan, Indonesian Rupiah, Korean Won, Malaysian Ringgit, Philippine Peso and Thai Baht.

[4] Australian Dollar, Canadian Dollar, Euro, Japanese Yen, New Zealand Dollar and Pound Sterling.

Here, the positive (negative) lnr_t indicates rupee depreciation (appreciation) against the US dollar. USD/INR return is influenced by its past values and an error term (ε_t) reflecting shocks impacting the exchange rate.

$$lnr_t = \beta_0 + \beta_1 lnr_{t-1} + \varepsilon_t \quad ...(2)$$

The error term ε_t is a function of lagged information (Ω_{-1}). Further, ε_t is assumed to be normally distributed with zero mean and its variance (h_t) is defined as:

$$\varepsilon_t|\Omega_{-1} \sim \mathrm{N}(0, h_t) \quad ...(3)$$

The, variance equation (h_t) is as follows:

$$h_t = \alpha_0 + \alpha_1\varepsilon_{t-1}^2 + \alpha_2 h_{t-1} + \gamma|\alpha_3 Intv_t + \alpha_4 FII_{Equity_{(t-2)}} + \alpha_5 Brent_t| \quad ...(4)$$

Here, α_1 and α_2 are the coefficients of autoregressive conditional heteroscedasticity (ARCH) and GARCH terms, respectively. $Intv_t$ is Reserve Bank's intervention, FII_{Equity} is foreign equity flows[5], and $Brent_t$ is Brent crude oil prices.

The residual diagnostics of the estimated model shows no ARCH effect suggesting no autocorrelation in residuals.

The results indicate that the Reserve Bank's intervention was effective in reducing USD/INR volatility, while higher variation in foreign equity outflows and higher Brent crude oil prices led to increased volatility in the USD/INR exchange rate (Table 1).

Table 1: GARCH (1,1) Estimation Results
(Sample Period: April 2022 to March 2023)

Variable	Coefficient	z-Statistic	Probability
Dependent Variable: lnr_t			
C	0.053***	3.73	0.01
$lnr_{(t-1)}$	-0.10	-1.38	0.16
Variance Equation: $h_t = \alpha_0 + \alpha_1\varepsilon_{t-1}^2 + \alpha_2 h_{t-1} + \gamma|\alpha_3 Intv_t + \alpha_4 FII_{Equity_{(t-2)}} + \alpha_5 Brent_t|$			
C	0.045***	6.29	0.00
$ARCH_{-1}$	0.53***	4.69	0.00
$GARCH_{-1}$	0.20**	2.41	0.01
$Intv_t$	-0.0227***	-3.60	0.00
$FII\ Equity_{(t-2)}$	0.000036**	2.33	0.01
$Brent_t$	0.0014**	2.41	0.01
Log-likelihood -26.96		Total observations	266
Durbin-Watson stat 1.93		Akaike info criterion	0.26
		ARCH(LM)	0.56 (0.45)

*** and ** indicate significance at 1 per cent and 5 per cent level, respectively.
Source: RBI staff calculations.

Research/Analytical Studies

V.22 The Department carried out analytical research on several topical issues including exchange rate volatility in emerging market economies.

Agenda for 2023-24

V.23 During the year 2023-24, the Department plans to achieve the following goals:

- To carry out liquidity management operations effectively through all available tools, in line with the monetary policy stance;
- To continue to conduct foreign exchange operations in an effective manner to curb undue volatility in the USD/INR exchange rate; and
- To continue to conduct policy-oriented research and analysis on financial markets so as to guide market operations strategies on an ongoing basis (*Utkarsh* 2.0).

4. FOREIGN EXCHANGE DEPARTMENT (FED)

V.24 The mandate of the Foreign Exchange Department (FED) is to facilitate external trade and payments and promote an orderly development of the foreign exchange markets, by framing simple yet comprehensive, time-consistent, and principles-based policies. In furtherance of the stated mandate and continuing with the Department's mission to streamline FEMA, which

[5] The period contains mostly net outflows from Indian market.

includes aligning the regulatory framework to meet the needs of the present business and economic scenario, the Department has sustained its efforts to improve the ease of doing business and reduce the compliance burden. In this regard, the Department overhauled the overseas investment (OI) regime by issuing new Regulations and Directions to complement the new OI Rules issued by the Central Government; extended the late submission fee (LSF) framework for all reporting delays under FEMA; and liberalised the external commercial borrowing (ECB) guidelines to diversify and expand the source of foreign funding. Further, to boost export growth and to support the increasing interest of the global trading community in the Indian Rupee (INR), an additional arrangement for invoicing, payment, and settlement of exports and imports in INR, has also been put in place by the department.

Agenda for 2022-23

V.25 The Department had set out the following goals for 2022-23:

- Continue rationalisation of the FEMA regulations by consolidating existing regulations of similar subjects, to obviate frequent issuance of amendment notifications, and aligning definitions across notifications/regulations (Paragraph V.26);
- Implementation of the revised computation matrix for compounding of contraventions under FEMA 1999 (*Utkarsh*) [Paragraph V.27];
- A comprehensive review of the Liberalised Remittance Scheme (LRS) to address various issues and inconsistencies in the scheme (Paragraph V.28);
- To continue automation of process of submission of various returns for regulatory compliance by leveraging technology (Paragraph V.29);
- Conducting awareness programmes and creation of digital content on an ongoing basis (*Utkarsh*) [Paragraph V.30]; and
- To continue to delegate more powers to AD banks and regional offices (ROs) for faster implementation of policy changes (Paragraph V.31).

Implementation Status

Rationalisation of Compounding Proceedings Rules

V.26 A rationalised draft Foreign Exchange Management (Compounding Proceedings) Rules, 2022 to supersede the extant Foreign Exchange (Compounding Proceedings) Rules, 2000, has been forwarded to the Government of India. Apart from aligning provisions contained in the Rules with those contained in the Act, the draft Rules propose the following major amendments:

- Enhancing the compounding powers of the RBI officers designated as Compounding Authorities;
- Enabling electronic/online modes of payment for compounding application fees and compounding amount; and
- Enabling the powers to Reserve Bank to lay down the procedure for compounding.

Implementation of the Revised Computation Matrix for Compounding of Contraventions under FEMA, 1999

V.27 Post review of the existing guidance note on computation matrix for calculation of compounding amount, a revised matrix, which provides simplified and standardised guidance for calculating the compounding amount, is at an advanced stage of finalisation.

Comprehensive Review of the Liberalised Remittance Scheme (LRS)

V.28 Under LRS, authorised dealers (ADs) may freely allow remittances by resident individuals up to US$ 2,50,000 per financial year (April-March) for any permitted current or capital account transaction. A comprehensive review to address various issues in the scheme, covering, *inter alia*, the legal framework, annual limit, permitted purposes, and repatriation requirements, under the Scheme has been undertaken and a revised LRS will be issued in due course.

Automation of Process of Submission of Various Returns - Discontinuation / Merger / Online Submission of Returns

V.29 In view of the recommendations by the Regulations Review Authority (RRA 2.0) related to discontinuation/merger or conversion of extant 65 regulatory paper-based returns into online returns on February 18, 2022, authorised persons (APs) have been notified, about the conversion of 21 returns into online submission. In addition, one return, namely 'quarterly return on guarantee availed and invoked from non-resident entities', has been discontinued/merged. Subsequently, AD banks were advised about the discontinuation of the said return with effect from the quarter ending June 2022. This migration to online returns will help in reducing the cost of regulatory compliance for the reporting entities while improving the accuracy, speed, and quality of data submission and enhancing the ease of doing business.

Conducting Awareness Programmes and Creation of Digital Content

V.30 Regional offices (ROs) have been conducting various workshops to supplement the simplification of regulations at the Central Office. The workshops for APs and FEMA exhibition-cum-townhall events during the year, where trade and industry bodies and users of foreign exchange were the participants, have been conducted by ROs to explain the recent policy changes and obtain feedback on ground-level implementation issues. Further, pursuant to the issuance of rationalised Overseas Investment (OI) Rules/Regulations, workshops for AD banks and ROs designated to process late submission fee (LSF) applications under the new OI regime were conducted. In addition to the above, the various guidelines/instructions are disseminated through Master Directions, Training Modules and Frequently Asked Questions (FAQs).

Delegation of Powers to AD Banks and ROs: Late Submission Fee for Reporting Delays Related to Overseas Investment Transactions - Standard Operating Procedure (SOP)

V.31 Keeping with the spirit of liberalisation, and with a view to encouraging ease of doing business, the late submission fee (LSF) concept has been introduced in the Foreign Exchange Management (Overseas Investment) Regulations, 2022, which is implemented at RO level, for which seven ROs, *viz*., Ahmedabad, Bangalore, Chennai, Hyderabad, Kolkata, Mumbai, and New Delhi were identified. Subsequently, a detailed SOP and guidance note on calculation of LSF in overseas investment transactions was issued on August 26, 2022.

Major Initiatives

Comprehensive Review of Foreign Exchange Management (International Financial Services Centre) Regulations, 2015

V.32 The Foreign Exchange Management (International Financial Services Centres) Regulations, 2015 were issued on March 2, 2015. However, the IFSC Authority (IFSCA) has been set up under the provisions of IFSC Authority Act, 2019. Consequently, several provisions of the regulations *ibid,* have become redundant. Accordingly, a comprehensive review of the regulations was carried out and the draft revised notification under FEMA, as well as the notification to be issued by the Government under the Special Economic Zone (SEZ) Act, have been forwarded to the Government of India for finalisation.

Government of India-Guaranteed Term Loan Extended by State Bank of India (SBI) to the Government of Sri Lanka - Settlement of Current Account Transactions with Sri Lanka in INR

V.33 In order to facilitate the settlement of Indian exports to Sri Lanka, undertaken as part of the term-loan agreement of US$ 1.0 billion between SBI and the Government of Sri Lanka, such transactions have been permitted to be settled in INR outside the Asian Clearing Union (ACU) mechanism since May 19, 2022.

V.34 In addition, AD Cat-I Banks have been advised on July 8, 2022, that all eligible current account transactions including trade transactions with Sri Lanka shall be settled in any permitted currency outside the ACU mechanism until further notice.

Import of Gold by Qualified Jewellers as Notified by IFSCA through India International Bullion Exchange IFSC Limited (IIBX)

V.35 As per the Directorate General of Foreign Trade (DGFT) notification, qualified jewellers (as notified by International Financial Services Centres Authority - IFSCA) are permitted to import gold under specific Indian Trade Classification (ITC) based on Harmonised System (HS) codes through India International Bullion Exchange IFSC Limited (IIBX), in addition to the nominated agencies (as notified by DGFT) and nominated banks (as notified by the Reserve Bank for import of gold). AD banks have been permitted since May 25, 2022, to allow qualified jewellers (as notified by IFSCA) to remit advance payment to enable them to import gold through IIBX in IFSC, subject to specified conditions.

Strategic Policy for Cross-Border Payments in INR

V.36 As a part of the long-term economic reform agenda for creation of an efficient cross-border payment and settlement system to improve the operational efficiency for meeting the needs of the country, the Reserve Bank had operationalised a framework for international trade payments in domestic currency through issuance of a circular to banks on July 11, 2022. This will enable Indian banks and INR to become a wider integral part of international trade and international supply chain.

V.37 Given India's growing foreign trade and the recent geopolitical developments, a complementary system to the existing mechanism to encourage trade payment and settlement in INR is being explored. The system can be tailored to encourage use of INR for cross-border trade and further enhance Indian exports, thereby generating additional employment and income.

V.38 The mechanism introduced in July 2022 is an additional arrangement for denominating, invoicing, and effecting payment and settlement of exports/imports in INR and would coexist with the current practice of trade payment and settlement in freely convertible foreign exchange. It has been envisaged that settlement of international trade in INR may take place following a voluntary and gradual principle and trading partners should also have a choice to use the existing arrangement. The benefits are twofold: (i) it would be a mutually beneficial mechanism for both countries in terms of conservation of foreign exchange reserves through settlement of full or part of the trade transactions through national currencies (INR and partner country currency). Payment and settlement in INR and partner country currency would reduce costs such as hedging and conversion; and (ii) the surplus Rupee balances in the special Rupee *vostro* accounts can be used for other remunerative purposes on reciprocal arrangements between the partner countries.

External Commercial Borrowings (ECB) Policy – Liberalisation Measures

V.39 In order to further diversify and expand the sources of forex inflows, the Reserve Bank *vide* its press release dated July 6, 2022, on 'Liberalisation of Forex Flows' had announced the temporary increase of the ECB limit under the automatic route from US$ 750 million or its equivalent per financial year to US$ 1.5 billion and the all-in-cost ceiling by 100 basis points (bps) for borrowers of investment-grade rating. These temporary measures were available for the ECBs raised up to December 31, 2022. Accordingly, after making necessary amendments in FEMA 3(R) [Foreign Exchange Management (Borrowing and Lending) Regulations, 2018], all AD Cat-I Banks were notified about the same. Post the review of the guidelines, new ECB agreements amounting to US$ 15.09 billion were concluded during August to December 2022, out of which, US$ 6.4 billion were concluded under the temporarily enhanced limit of US$ 1.5 billion under the automatic route. Besides, during the same period, ECB agreements worth US$ 44 million and EUR 0.1 million were also concluded at the revised all-in-cost ceiling provided for investment-grade borrowers.

Late Submission Fee for Reporting Delays under Foreign Exchange Management Act, 1999 (FEMA)

V.40 The concept of late submission fee (LSF) was introduced for reporting delays under the Foreign Exchange Management Act, 1999 (FEMA). LSF had been introduced for foreign investment (FI), ECBs, and overseas investment (OI) related transactions with effect from November 7, 2017, January 16, 2019 and August 22, 2022, respectively. To bring uniformity in the imposition of LSF across functions, a uniform matrix in line with the one for OI-related transactions for calculation of LSF, wherever applicable under FEMA, was introduced (Box V.3).

Box V.3

Operationalisation of a New Overseas Investment (OI) Regime

In keeping with the spirit of liberalisation and to promote ease of doing business, the Central Government and the Reserve Bank have been progressively simplifying the procedures and rationalising the rules and regulations under the Foreign Exchange Management Act, 1999. In this direction, a significant step has been taken with the operationalisation of a new Overseas Investment regime. Foreign Exchange Management (Overseas Investment) Regulations, 2022 have been notified in supersession of Foreign Exchange Management (Transfer or Issue of any Foreign Security) (Amendment) Regulations, 2004, and Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2015. The Foreign Exchange Management (Overseas Investment) Directions, 2022 issued on August 22, 2022, superseded Master Direction dated January 1, 2016, as amended from time to time. The new regime simplifies the existing framework for overseas investment by persons resident in India to cover wider economic activity and significantly reduces the need for seeking specific approvals. This will result in reduced compliance burden and associated compliance costs.

(Contd.)

Some of the significant changes brought about by the new rules and regulations are summarised below:

- Enhanced clarity with respect to various definitions such as 'overseas portfolio investment', 'net worth', 'step down subsidiary', *etc.;*
- Introduction of the concept of 'strategic sector' to facilitate overseas investment in sectors of national interest;
- In case of investigation by any investigative agency/ regulatory body against person resident in India, the requirement of the Reserve Bank approval for overseas investment/disinvestment has been replaced with a no objection certificate (NOC) from the respective agency;
- A mechanism of 'late submission fee (LSF)' has been introduced for taking on record delayed reporting;
- Issuance of guarantees to or on behalf of second or subsequent level step-down subsidiary (SDS) has been brought under the automatic route;
- Write-off on account of disinvestment, for loss-making foreign entities, has been allowed without any limit, subject to compliance with pricing and other guidelines;
- Allowing non-financial sector entities to make investment in financial service sector (except insurance and banking), subject to profitability criteria; and
- Flexibility in pricing guidelines for investment/ disinvestment has been introduced for valuation as per any internationally accepted pricing methodology.

Source: RBI.

Enabling Bharat Bill Payment System (BBPS) to Process Cross-Border Inbound Bill Payments under the Rupee Drawing Arrangement (RDA)

V.41 As announced in the Statement on Developmental and Regulatory Policies of August 5, 2022, with a view to enabling BBPS, an interoperable platform for standardised bill payment to process cross-border inbound bill payments, it has been decided to allow foreign inward remittances received under the Rupee Drawing Arrangement (RDA), to be transferred to the know your customer (KYC) compliant bank account of the biller (beneficiary) through BBPS, subject to certain conditions. This shall facilitate NRIs to undertake utility, education, and other bill payments on behalf of their families in India.

Foreign Investment in India - Rationalisation of Reporting in Single Master Form (SMF) on FIRMS Portal

V.42 An online Foreign Investment Reporting and Management System (FIRMS) was introduced on September 1, 2018, for reporting foreign investments in India. Accordingly, based on the feedback received from various stakeholders including investee companies and AD banks, the FIRMS portal was revamped to introduce the system of auto-acknowledgment of reporting of forms and online calculation of Late Submission Fee (LSF), *w.e.f.,* January 5, 2023. The system was changed with a view to expedite and ease the process of reporting foreign investment in the country.

Ongoing Software Projects, viz., SPECTRA and AP Connect

V.43 Authorised person (AP) connect has been operationalised on Pilot Go-Live basis with effect from December 22, 2022. As regards Software Platform for External Commercial Borrowings and Trade Credits Reporting and Approval (SPECTRA), the same is at an advanced stage of implementation.

Agenda for 2023-24

V.44 The Department's strategy for 2023-24 is to focus on consolidating and carrying forward all the above initiatives. Going forward, the focus will remain on ensuring that the FEMA operating framework is in sync with the needs of the evolving macroeconomic environment. In addition, efforts would be made towards role enrichment of APs by way of delegation of powers, and rationalisation of reporting requirements with the intent of better data management and reduction in the cost of compliance. Accordingly, the Department has formulated the following strategic action plan for the year 2023-24:

- Review of Compounding Proceedings Rules, under the Foreign Exchange Management Act (FEMA), 1999 (*Utkarsh* 2.0);
- Review of the authorisation framework of APs under FEMA (*Utkarsh* 2.0);
- Rationalisation of the LRS (*Utkarsh* 2.0);
- Rationalisation of regulations on Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2016 (*Utkarsh* 2.0);
- Review of guidelines related to Rupee accounts of non-residents (*Utkarsh* 2.0);
- Rationalisation of Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019;
- Review of supervisory framework for full-fledged money changers and non-bank AD Category II;
- Rationalisation of guarantee regulations; and
- Rationalisation/simplification of trade guidelines (*Utkarsh* 2.0).

5. CONCLUSION

V.45 The Reserve Bank undertook proactive measures during the year to contain market volatility, ensure orderly conditions in the market, and anchor market expectations, notwithstanding formidable global spillovers, while sustaining its focus on further development of key market segments. Liquidity conditions were modulated to align them with the shift in the monetary policy stance towards withdrawal of accommodation. The Reserve Bank also undertook regulatory initiatives to curb unauthorised forex trading platforms. It continued with its efforts to align the regulatory framework with the changing needs of the economy with an emphasis on lowering the compliance burden. Looking ahead, the Reserve Bank would continue to remain watchful of new risks, assess emerging opportunities, and seek market feedback to further strengthen regulations covering the entire gamut of money, government securities and foreign exchange market, with a view to reducing systemic risk and enhancing market transparency. The liquidity operations will continue to be in sync with the stance of the monetary policy while the foreign exchange operations will be guided by the objective of ensuring orderly movements in the exchange rate of the rupee.