VI REGULATION, SUPERVISION AND FINANCIAL STABILITY

Despite a moderate revival in economic activity coupled with an upturn in credit growth during the year, the Indian banking sector continued to battle with significant deterioration in loan quality. Consequently, the Reserve Bank had to undertake supervisory measures including an asset quality review (AQR) for restoring the health of the banking system over the medium term. On the regulatory front, the Reserve Bank continued its efforts to strengthen the prudential policy framework to effectively address the challenge of rising stressed assets and facilitate the restoration of stalled projects. The process of transition of banks in India to the Indian Accounting Standards (Ind AS) converged with International Financial Reporting Standards (IFRS) was initiated. The commitment to enhancing financial inclusion and competition in the banking sector was reinforced with the approval to set up small finance and payments banks and a move to on-tap licensing of universal banks. With the objective of encouraging competition while reducing regulatory arbitrage, the process of aligning the regulatory frameworks for various segments of the financial system was carried forward. The year also witnessed complete operationalisation of the Charter of Customer Rights, which will play a pivotal role in ensuring consumer protection in the banking sector in the years to come.

VI.1 Notwithstanding the moderate pick-up in economic growth and credit conditions, the banking sector continued to grapple with the challenge of rising non-performing assets (NPAs) during 2015-16. To address the concerns of asset quality, the Reserve Bank initiated supervisory action in the form of an asset quality review (AQR) during the year. Based on the observations made during the AQR, banks proactively recognised stressed assets, which resulted in a predictable increase in provisioning and a decline in profitability, particularly of public sector banks (PSBs). While stressed assets affected the overall performance of banks, there was an improvement in capital positions during the year due to changes in the regulations governing capital adequacy which aligned them with global regulatory norms.

VI.2 While being vigilant about the regulation and supervision of commercial banks, the Reserve Bank remained committed to the ongoing agenda of harmonising prudential regulations across various segments of the financial sector, *viz*., co-operative banks, non-banking financial companies (NBFCs) and commercial banks. The year witnessed the entry of new players in the banking sector with the establishment of small finance and payments banks. These banks are expected to cater to niche domains and under-served segments of the population, and thereby further financial inclusion while fostering competition in the banking sector.

VI.3 An important concern in achieving financial inclusion and stability relates to customer services and protection. Towards this end, the Reserve Bank fully operationalised the Charter of Customer Rights. It also undertook a comprehensive review of the Banking Ombudsman (BO) scheme to address challenges posed by the recent growth in banking consumers following the implementation of the Pradhan Mantri Jan-Dhan Yojana (PMJDY).

VI.4 Thus, the year witnessed a slew of policy actions in pursuance of the three pillars envisaged by the Reserve Bank for improving the regulation and supervision of the financial sector, *viz*., strengthening the banking structure through new players; expanding financial access; and improving the system's ability to deal with distress.

FINANCIAL STABILITY UNIT

VI.5 The Financial Stability Unit (FSU) within the Reserve Bank is entrusted with the responsibility of macro-prudential surveillance through systemic stress tests and other tools as well as dissemination of information relating to the status of and challenges to financial stability through the bi-annual Financial Stability Report (FSR). It also acts as a secretariat to the Sub-Committee of the apex institutional mechanism for financial stability in the country, *viz.*, the Financial Stability and Development Council (FSDC).

Agenda for 2015-16: Implementation Status

VI.6 In 2015-16, the FSR was published in December 2015 (along with the Report on Trend and Progress of Banking in India) and June 2016, as planned. The stress testing framework was refined by incorporating sectoral probability of defaults and modelling corporate sector distress. In addition, distress in select industrial sectors and its impact on the banking sector was examined.

VI.7 The Sub-Committee of FSDC held two meetings in 2015-16 and reviewed various issues relating to, *inter alia,* central know your customer registry (CKYCR), International Financial Services Centre, development of corporate bond market, peer-to-peer (P2P) lending, regulation of credit guarantee schemes, risks in deposit mobilisation by multi-state co-operative societies and the Stewardship Code.[1] The Sub-Committee recommended the formation of an inter-regulatory group on financial technology (Fin Tech) to examine the models followed internationally and determine an appropriate regulatory framework in this regard (also see Box VI.2). The Sub-Committee also agreed to set up a working group to formulate an effective and comprehensive 'National Gold Policy'. Furthermore, a Working Group on Corporate Bonds (Chairman: H. R. Khan) with representation from the central government and various financial sector regulators was constituted following the recommendations of the Sub-Committee.

VI.8 Through its two meetings, the Inter-Regulatory Technical Group (IRTG) – a sub-group of the FSDC Sub-Committee – deliberated upon a range of issues, such as legal entity identifier (LEI), a regulatory framework for NBFC-account aggregator (AA), securitisation, a single entity undertaking multiple activities and progress on the Shadow Banking Implementation Group.

Agenda for 2016-17

VI.9 Going forward, besides macro-prudential surveillance, the publication of the bi-annual FSR is envisaged along with conducting meetings of the FSDC Sub-Committee. The study of select industries, especially with regard to the banking sector's exposure to these industries, will also be undertaken during the year.

REGULATION OF FINANCIAL INTERMEDIARIES

Commercial Banks: Department of Banking Regulation (DBR)

VI.10 DBR, which is the nodal department for regulation of commercial banks, has been proactively addressing both the time and cross-sectional dimensions of risks to preserve systemic stability. Apart from stability, its focus has also been on developing an inclusive and competitive banking structure through appropriate regulatory measures. The regulatory framework is also tweaked in tune with the requirements of the Indian

[1] The Stewardship Code aims to enhance the quality of engagement between asset managers and companies to help improve the long-term risk-adjusted returns to shareholders.

economy while suitably adopting international best practices.

Agenda for 2015-16: Implementation Status

Financial Stress and Reinforcements

VI.11 During 2015-16, the Reserve Bank continued to fortify the regulatory framework for dealing with stressed assets, *inter alia*, by way of a more effective joint lenders' forum (JLF) with senior-level representation from banks, change of ownership in borrowing entities even outside the strategic debt restructuring (SDR) scheme, and specifying the criterion for divestment of banks' holdings in favour of new promoters under the SDR scheme. Furthermore, to strengthen the ability of lenders for deep financial restructuring, the Reserve Bank introduced the Scheme for Sustainable Structuring of Stressed Assets (S4A). The Insolvency and Bankruptcy Code was also passed during the year to strengthen the framework for resolution of corporate entities, partnership firms and individuals in a time-bound manner. To further improve recovery, amendments to the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 and Recovery of Debts Due to Banks and Financial Institutions (RDDBFI) Act, 1993 have been passed by Parliament (Box VI.1).

Box VI.1
Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill, 2016

In view of the difficulties faced by banks and financial institutions in recovering loans and enforcing securities charged with them, a need was felt to amend the existing debt laws. Accordingly, the Enforcement of Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Bill, 2016 has been passed by Parliament in August 2016.

A. Amendments to the SARFAESI Act, 2002 are proposed to improve recovery and augment ease of doing business. These, *inter alia,* include:

- Registration of creation, modification and satisfaction of security interest by all secured creditors and provision for integration of registration systems under different laws relating to property rights with the Central Registry to create a central database of security interests on property rights;
- Enabling non-institutional investors to invest in security receipts;
- Bringing hire purchase, financial lease and conditional sale under its ambit;
- Strengthening the regulation of asset reconstruction companies (ARCs) by the Reserve Bank, including powers to audit, inspect, change directors, issue directions for regulation of management fee and impose penalties;
- Making debenture trustees at par with secured creditors;
- Specifying the timeline for taking possession of secured assets; and
- According priority to secured creditors in repayment of debts over all other debts.

B. Amendments to the RDDBFI Act, 1993 are proposed to reduce stressed assets in the banking system. These, *inter alia,* include:

- Expeditious adjudication of recovery applications and empowering the central government to provide uniform procedural rules for conducting proceedings in Debt Recovery Tribunals (DRTs) and Debt Recovery Appellate Tribunals (DRATs);
- Instituting electronic filing of recovery applications, documents and written statements; issuing summons by the tribunals in electronic forms; and display of interim and final orders of DRTs and DRATs on their websites; and
- According priority to secured creditors in repayment of debts over all other claimants including claims of the central government, state government or local authorities.

C. The Bill also seeks to amend the Indian Stamp Act, 1899 to exempt assignment of loans in favour of ARCs from stamp duty; and the Depositories Act, 1996 to facilitate the transfer of shares held in pledge or on conversion of debt into shares in favour of banks and financial institutions.

VI.12 A discussion paper (DP) on 'Large Exposures Framework and Enhancing Credit Supply through Market Mechanism' was released by the Reserve Bank in March 2015. The DP included proposals on the convergence of extant exposure norms with the 'Large Exposures Framework' (LEF) of the Basel Committee on Banking Supervision (BCBS) as also a proposal to encourage market mechanism for reducing the reliance of large corporate borrowers on the banking system. While the former addressed the concentration risks for individual banks, the latter dealt with those at the systemic level.

VI.13 In view of the importance of concentration risks at the systemic level, a separate DP was also released in May 2016 on the 'Framework for Enhancing Credit Supply for Large Borrowers through Market Mechanism'. This DP defined a 'specified borrower' and a 'normally permitted lending limit' (NPLL) for such a borrower. Furthermore, it proposed a disincentive mechanism for incremental borrowing by such a borrower from the banking system beyond NPLL.

Small Finance and Payments Banks

VI.14 As part of its initiatives towards financial inclusion through a bouquet of banking products, including small credit, small savings and payments/ remittances, the Reserve Bank issued in-principle approval for setting up of 11 payments banks and ten small finance banks (SFBs) in September 2015 and October 2015, respectively. The Reserve Bank also worked towards finalising the regulatory framework for these new entities. Furthermore, in March 2016, the first SFB licence was granted to Capital Small Finance Bank Limited – a case of conversion of a local area bank (LAB) into a SFB. The first payments bank licence was granted to Airtel Payment Bank Ltd. in April 2016. In June 2016, the second SFB licence was granted to Equitas Small Finance Bank.

Lending Rate based on Marginal Cost of Funds

VI.15 In order to improve transparency in the methodology followed for determining lending rates and strengthening monetary policy transmission, banks were mandated to price their credit using the marginal cost of funds based lending rate (MCLR) as the internal benchmark. Details about MCLR are given in Chapter III.

On-tap Licensing of Banks

VI.16 With the objective of encouraging greater competition and innovation in the banking system, guidelines for on-tap licensing of universal banks were released in August 2016. Apart from instituting a continuous process of licensing of banks in the private sector, these guidelines have mooted, *inter alia*, inclusion of resident individuals/ professionals with experience in banking and finance but exclusion of large industrial/business houses as eligible promoters, and making a non-operative financial holding company (NOFHC) mandatory only under certain conditions.

Transition to Indian Accounting Standards (Ind AS)

VI.17 To pave the way for a time-bound transition of the existing accounting framework for banks in India to the Indian Accounting Standards (Ind AS) converged with IFRS, banks were advised in February 2016 to comply with the Ind AS in the preparation of financial statements for the accounting periods beginning April 1, 2018 with comparatives for the period ending March 31, 2018. Banks were also advised to initiate the implementation process with immediate effect under the oversight of the audit committees of their boards.

Master Directions

VI.18 Following the announcement in the Reserve Bank's Annual Report 2014-15, ten Master Directions, *viz.*, on interest rate on deposits and advances; KYC (consolidating all relevant instructions issued by different departments of the Reserve Bank); amalgamation; issue and pricing of shares of private sector banks; ownership in private sector banks; prior approval for acquisition of shares or voting rights in private sector banks; Gold Monetisation Scheme; financial services provided by banks; and presentation, disclosure and reporting by All-India Financial Institutions (AIFIs) were issued during the year. These directions are expected to impart more clarity and focus to communication with stakeholders.

Future of Local Area Banks (LABs) and Ownership in Private Banks

VI.19 Consultations with the central government on broad options for the future set-up of LABs were underway during the year. The extant guidelines on ownership in private sector banks were revisited with a view to meeting the need for additional capital consequent to the implementation of Basel III capital regulations and rationalisation of the ownership limits for these banks.

Governance Reforms in Public Sector Banks

VI.20 Following the recommendations made by the Committee to Review Governance of Boards of Banks in India (Chairman: Shri P. J. Nayak), the Banks Board Bureau (BBB) was set up by the central government with support from the Reserve Bank to infuse greater professionalism in the constitution and operation of the boards of PSBs. The BBB started functioning from April 8, 2016.

Agenda for 2016-17

VI.21 In pursuance of the regulatory stance in 2015-16, the Reserve Bank will continue to monitor and respond to banks' asset quality issues in 2016-17. Furthermore, the policy on prudential and implementation aspects of the expected credit loss (ECL) approach, as envisaged in Ind AS 109, is intended to be finalised. A review of the guidelines/instructions on various aspects relating to Ind AS will be undertaken during the year. Efforts will also be initiated for capacity building on Ind AS both internally and in banks.

VI.22 Draft guidelines for computing exposure for counterparty credit risk (CCR) arising from derivative transactions and capital requirements for bank exposures to central counterparties (CCPs) were issued for comments in June 2016. The final guidelines shall be issued by end-December 2016 for implementation from April 1, 2017. A discussion paper on margin requirements for non-centrally cleared derivatives was also released in May 2016. Final guidelines in this regard will be issued during the first half of 2016-17. Furthermore, draft guidelines on the LEF and the revised securitisation framework in alignment with the BCBS standards are also proposed to be issued during the year.

VI.23 In May 2015, draft guidelines on the net stable funding ratio (NSFR) were issued, taking into account the BCBS's final rules of October 2014. The objective of NSFR is to ensure that banks maintain stable funding profiles in relation to the composition of their assets and off-balance sheet activities, limiting their over-reliance on short-term wholesale funding. The final guidelines on NSFR will be issued in the second half of 2016-17 after a consultative process, for implementation from January 1, 2018.

VI.24 It is proposed to review and rationalise the branch authorisation framework for domestic scheduled commercial banks and the existing guidelines with regard to export credit. It is also planned to extend the Basel III framework to AIFIs in 2016-17. Banking, like many other fields, has been revolutionised by digital innovations in recent years. To assess the potential in this sector, the Reserve Bank has set up an Inter-regulatory Working Group on Fin Tech and Digital Banking (Box VI.2). The report of the Working Group will help in designing an appropriate regulatory framework for these innovative institutions and

Box VI.2
Fin Tech and Digital Innovation – Opportunities, Challenges and Risks

Financial services, including banking services, are at the cusp of a revolutionary change driven by technological and digital innovations. Fin Tech is an umbrella term coined to denote new competitors (typically non-financial firms) bringing technological innovations having a bearing on financial services. Digital banking, block chain technology, distributed ledgers, big data and P2P/business-to-business (B2B)/business-to-consumers (B2C) platforms which bring together lenders and borrowers are some of the more recent innovations in Fin Tech. These offer tremendous opportunities and benefits for the financial sector. Convenience and speed of performance, real-time transactions, lower transaction costs, distributed ledger data availability for information and decision making, product tailoring and absence of intermediaries are some of the benefits of Fin Tech.

Fin Tech is of particular relevance in India given the national aspiration for universal financial inclusion, ensuring last mile reach of finance at affordable costs. A combination of cloud computing, hand-held devices and mobile smartphones have aided the expansion of Fin Tech in India. The newly introduced payments banks are expected to be important players in the arena of Fin Tech given the central role of technology in their operations.

However, Fin Tech brings with it several challenges for the regulator given its departure from the traditional process of financial intermediation. The risks entailed therein are not just limited to technology but could, *inter alia,* involve: issues arising from transactions in financial products by unregulated financial and non-financial entities; outsourcing of products/services; and acquisition of software solutions without access to/awareness about source codes.

In view of the 'disruptive' potential of Fin Tech, it is necessary to examine the need for regulation and design an appropriate regulatory framework, if required. Hence, the Reserve Bank has set up an Inter-regulatory Working Group on Fin Tech and Digital Banking (Chairman: Shri S. Sen) in July 2016. The Group, *inter alia*, will assess the opportunities and risks from Fin Tech for customers and other stakeholders. Furthermore, it will examine the implications and challenges of Fin Tech for various financial sector functions, including intermediation, clearing and payments being taken up by non-financial entities, and suggest appropriate regulatory response, if any.

products. The possibilities of licensing other differentiated banks such as custodian banks, and wholesale and long-term financing banks will be explored in a paper to be released for comments by September 2016.

VI.25 It is observed that some sections of the Indian society have remained financially excluded for religious reasons that preclude them from using banking products with an element of interest. Towards mainstreaming these excluded sections, it is proposed to explore the modalities of introducing interest-free banking products in India in consultation with the Government.

Co-operative Banks: Department of Co-operative Bank Regulation (DCBR)

VI.26 Over the years, the Reserve Bank has played a key role in the revival and strengthening of the co-operative banking sector by instituting an appropriate regulatory and supervisory framework. In 2015-16 as well, DCBR, the department in-charge of prudential regulation of co-operative banks comprising urban co-operative banks (UCBs), state co-operative banks (StCBs) and district central co-operative banks (DCCBs), took several initiatives for strengthening the framework further.

Agenda for 2015-16: Implementation Status

VI.27 The report of the High Powered Committee on UCBs (HPC) was placed on the Bank's website and comments of the public were obtained. A meeting was held in May 2016 with the stakeholders to elicit their views on the implementation of recommendations of the HPC. Furthermore, workshops were conducted for statutory auditors of UCBs to improve the quality of audit.

Harmonisation of Regulatory Policies

VI.28 The Reserve Bank has been in the process of harmonising regulations within the co-operative space, *i.e.*, between urban and rural co-operative banks as well as aligning regulations in a carefully calibrated manner between co-operative and commercial banks. Accordingly, harmonisation of the following regulations was accomplished during the year: (i) valuation of gold jewellery accepted as security/collateral; (ii) provision of internet banking to customers; (iii) issue of ATM-cum-debit cards; (iv) provision of value-added services through ATMs; and (v) investments in market infrastructure companies (MICs).

Revival and Licensing of Unlicensed DCCBs

VI.29 In order to ensure that only licensed entities occupy the co-operative banking space in the interest of depositors, the licensing norms for co-operative banks were revised in 2009. The positive fallout of these policy efforts could be seen in the decline in the number of unlicensed StCBs and DCCBs. For the revival and licensing of 23 DCCBs that continued to be unlicensed, a scheme was launched by the central government in 2014, the details and outcome of which are given in Box VI.3.

Developments relating to Scheduling, Licensing and Mergers

VI.30 Five non-scheduled co-operative banks, *viz.*, Apna Sahakari Bank Ltd., Mumbai; Vasai Vikas Sahakari Bank Ltd., Thane; Jalgaon Peoples Co-operative Bank Ltd., Jalgaon; Rajarambapu Sahakari Bank Ltd., Peth, Sangli; and Uttarakhand State Co-operative Bank Limited, Haldwani were included in the Second Schedule to the RBI Act, 1934 during the year. Following the formation of the state of Telangana, the Telangana State Co-operative Apex Bank Ltd., which commenced its operations on April 2, 2015, was issued a banking licence on April 18, 2016. Five proposals for

Box VI.3
Revival and Licensing of Unlicensed DCCBs

With the rollout of a revival package by the central government for short-term co-operative credit institutions in 2006 (based on the recommendations of the Task Force on Revival of Rural Co-operative Credit Institutions (Chairman: Professor A. Vaidyanathan)), and the revision in licensing norms by the Reserve Bank in 2009, the number of unlicensed entities in the co-operative banking space has been on a decline. While the number of unlicensed StCBs reduced from 17 to zero, the number of unlicensed DCCBs came down sharply from 296 to 23 by June 2013.

In November 2014, the central government announced another scheme for the revival of 23 unlicensed DCCBs in four states (16 in Uttar Pradesh, three each in Jammu and Kashmir and Maharashtra, and one in West Bengal). Under the scheme, the estimated capital infusion for DCCBs was placed at ₹23.76 billion of which, ₹6.73 billion was to be contributed by the central government, ₹14.65 billion by state governments and ₹2.38 billion by the National Bank for Agriculture and Rural Development (NABARD). As per the scheme, the central government's contribution will be released through NABARD as an interest-free loan and will be converted into a grant on the fulfilment of conditions/deliverables outlined in the scheme. Among the conditions outlined, the DCCBs have been asked to (a) reduce their NPA ratios by at least 50 per cent by March 31, 2017; (b) achieve a growth of 15 per cent in their deposits in the following two years; (c) prepare monthly monitorable action plans; (d) ensure the appointment of competent CEOs fulfilling 'fit and proper' criteria; and (e) put in place appropriate corporate governance systems.

NABARD's contribution will be in the form of loans to respective state governments. Furthermore, state governments are expected to finance the additional fund requirements for meeting the capital to risk-weighted assets ratio (CRAR) of 7 per cent as on March 31, 2015. For implementing the scheme, a tripartite agreement in the form of a memorandum of understanding (MoU), stipulating the conditions/deliverables, was signed between the central government, the concerned state government and NABARD. Subsequent to the release of funds by the central government, the state governments of Maharashtra and Uttar Pradesh, and NABARD, licences were issued in 2015-16 to three DCCBs in Maharashtra and 11 DCCBs in Uttar Pradesh bringing down the number of unlicensed DCCBs to nine as on June 30, 2016.

mergers of UCBs were approved during the year and out of these, three were implemented.

Agenda for 2016-17

VI.31 The on-going process of harmonisation of regulations for co-operative banks will be continued in 2016-17. Implementation of the revival scheme of the central government will be pursued with a view to ensuring that the DCCBs covered under the scheme are licensed. Implementation of some recommendations of the HPC will be considered based on the feedback received from stakeholders.

Non-Banking Financial Companies (NBFCs): Department of Non-Banking Regulation (DNBR)

VI.32 NBFCs play a critical role in catering to under-served niche sectors. An orderly development of NBFCs has been a priority for the Reserve Bank as shadow banking operations have a bearing on the stability of the financial system. In 2015-16, the focus of DNBR was to take forward the process of harmonisation of regulations across NBFCs and banks and move towards activity-based regulation.

Agenda for 2015-16: Implementation Status

Continued Harmonisation of Prudential Regulations

VI.33 During the year, harmonisation of the following prudential regulations pertaining to NBFCs was undertaken: early recognition of financial distress; prompt steps for resolution and fair recovery for lenders, including guidelines on the formation of JLF and corrective action plan (CAP); factoring activities by banks and those for NBFC-factors; risk weights assigned to exposures to central/state government/s and claims guaranteed by state governments; risk weights with respect to investments in corporate bonds by standalone primary dealers; and strategic debt restructuring and refinancing of project loans.

NBFC-Account Aggregator and P2P Lending

VI.34 Towards a consolidated view of financial assets, a new category of NBFC, *viz*., NBFC-AA was proposed (Box VI.4). In addition, a

Box VI.4
NBFC-Account Aggregator

At present, financial asset holders such as holders of savings bank deposits, fixed deposits, mutual funds and insurance policies, get a scattered view of their financial asset holdings if the entities with whom these accounts are held fall under the purview of different financial sector regulators. This gap will be filled by account aggregators who will provide information on various accounts held by a customer in a consolidated, organised and retrievable manner. The option to avail the services of an account aggregator by a customer will be purely voluntary.

The draft directions governing NBFC-account aggregator (AA) were issued by the Reserve Bank in March 2016. Accordingly, the activities of NBFC-AA will be regulated by the Reserve Bank to ensure that the nature and terms of its services conform to prescribed standards. As per these guidelines, the business of an account aggregator will be entirely driven by information technology (IT). The account aggregator will not support any transaction in financial assets by its customers. The account aggregator will not undertake any business other than the business of account aggregation. However, deployment of investible surplus by the aggregator in instruments, not for trading, will be permitted. Pricing of services will be as per the board-approved policy of the account aggregator.

The account aggregator will ensure that the provision of services to a customer who has made a specific application for availing such services, will be backed by appropriate agreements/authorisations between the aggregator, customer and financial service provider. The information will be shared by the account aggregator only with the customer to whom it relates or any other person authorised by the customer. The account aggregator will be bound by the terms and conditions of the licence (such as customer protection, grievance redressal, data security, audit control, corporate governance and risk management framework). The account aggregator will have a Citizen Charter that explicitly guarantees the protection of the rights of customers.

Box VI.5

Peer-to-Peer Lending

Peer-to-peer (P2P) lending is an innovative form of crowd-funding with financial returns. It involves the use of an online platform to bring lenders and borrowers together and help in mobilising unsecured finance. The borrower can either be an individual or a business requiring a loan. The platform enables a preliminary assessment of the borrower's creditworthiness and collection of loan repayments. Accordingly, a fee is paid to the platform by both borrowers and lenders. Interest rates range from a flat interest rate fixed by the platform to dynamic interest rates as agreed upon by borrowers and lenders using a cost-plus model (operational costs plus margin for the platform and returns for lenders).

One of the main advantages of P2P lending for borrowers is that the rates are lower than those offered by money lenders/unorganised sector, while the lenders benefit from higher returns than those obtained from a savings account or from any other investment.

Although there has been significant growth in online lending platforms globally, there is no uniformity in the regulatory stance with regard to this sector across countries. While P2P lending platforms are banned in Japan and Israel, they are regulated as banks in France, Germany and Italy, and are exempt from any regulation in China and South Korea. Differences in regulatory stance emanate ideologically. It is argued that regulation may stifle the growth of this nascent sector. On the other hand, proponents of regulation argue that the unregulated growth of this sector may breed unhealthy practices by market players and may, in the long-run, have systemic concerns given the susceptibility of this sector to attract high risk borrowers and also weaken the monetary policy transmission mechanism.

In India, there are currently many online P2P lending platforms and the sector has been growing at a rapid pace. The Reserve Bank released a consultation paper on P2P lending in April 2016. The paper deliberated the advantages and disadvantages of regulating P2P platforms and underscored the need to develop a balanced regulatory approach that would protect lenders and borrowers without curbing the underlying innovations. Accordingly, P2P platforms are proposed to be regulated as a separate category of NBFCs. The feedback received on the paper from various stakeholders is being examined to finalise the regulatory framework.

consultation paper for designing a suitable regulatory framework for P2P lending was also released (Box VI.5).

Simplification of the Registration Process

VI.35 The process of issuing certificates of registration (CoRs) for NBFCs was simplified and rationalised. Accordingly, the number of documents to be submitted for CoR were reduced from 45 to about eight. Furthermore, NBFCs were divided into two categories for the purpose of CoR, *viz*., Type I and Type II. It was also decided to fast track applications of Type I NBFCs, which do not access public funds and do not have customer interface.

Agenda for 2016-17

VI.36 As in the past, the process of regulatory convergence between NBFCs and banks will be carried forward in 2016-17. Furthermore, the year will also witness policy measures towards grouping NBFCs into fewer categories. As part of public consultation process, the feedback from stakeholders and public on the draft directions for NBFC-AA and the consultation paper on P2P lending has been received. The feedback is being examined to finalise the directions and initiate the process of granting in-principle approval for NBFC-AA and also to finalise the contours of regulation of P2P platforms.

SUPERVISION OF FINANCIAL INTERMEDIARIES

Commercial Banks: Department of Banking Supervision (DBS)

VI.37 In India's bank-dominated financial system, DBS – entrusted with the responsibility of supervising scheduled commercial banks (SCBs) – plays a central role in ensuring systemic stability. Apart from SCBs, DBS also renders supervisory oversight of AIFIs and acts as the secretariat to the Inter-Regulatory Forum (IRF) set up under the aegis of the Sub-Committee of the FSDC for coordinated supervision of financial conglomerates (FCs).

Agenda for 2015-16: Implementation Status

VI.38 In the backdrop of continuing concerns about asset quality, the Reserve Bank conducted AQR during July-September 2015 of banks' loan assets against applicable norms stipulated by it. This exercise covered 36 major banks. The status of large borrowal accounts across banks was examined in a coordinated manner, extensively analysing off-site data available from the central repository for information on large credits (CRILC) and other data dumps. The exercise revealed significant divergence between the reported levels of impairment and actual positions. Hence, after multiple levels of review, the banks were advised to appropriately adjust the impairments in their books. While the immediate impact of the AQR was seen in the third quarter results, the major impact was expected to be reflected in the last quarter results for 2015-16. Furthermore, based on the experience gained over the past years, an Early Warning System (EWS) was set up and a modified Prompt Corrective Action (PCA) framework for banks is being finalised.

VI.39 During 2015-16, 34 more banks (including 28 small foreign banks with one/two branches) have been brought under the Supervisory Programme for Assessment of Risk and Capital (SPARC) framework. This marked the successful completion of the third cycle of Risk-Based Supervision (RBS) for banks operating in India since its introduction in 2012-13. An integral part of the RBS framework has been the capacity building of bank officials as well as Reserve Bank's supervisory staff. Accordingly, the Reserve Bank provided broad guidance on designing training programmes for internal skill enhancement, including the intended objectives, tentative coverage, methodology and resources for conceptualisation of these programmes. The Reserve Bank also conducted three focused workshops covering nearly its entire staff associated with the RBS. The workshops deployed case studies, quizzes and concept checker methods to achieve the desired skill transmission and assimilation.

VI.40 The Reserve Bank conducted sensitisation sessions for banks already under the RBS on the theme 'Ensuring Accuracy and Integrity of Information Submissions'. For new banks to be brought under the RBS from 2016-17, orientation workshops on SPARC covering the top management coupled with theme-based symposiums were conducted. Furthermore, the Reserve Bank arranged training programmes on analytical tools and information system (IS) audits for bank officials. During the year, the Reserve Bank also rolled out the systems audit and testing of systems in banks for information technology vulnerability/penetration.

VI.41 The Reserve Bank introduced the revised format for CRILC reporting for improved data collection from banks from the quarter ended September 2015. During the year, there were discussions between the Reserve Bank and the Insurance Regulatory and Development Authority (IRDA) for bringing insurance companies into the ambit of the CRILC system. A training programme for five insurance companies was also conducted to familiarise them with the system.

VI.42 The year witnessed successful migration of the off-site monitoring and surveillance system (OSMOS) returns to the eXtensible business reporting language (XBRL) platform. Banks also started reporting through the automated data flow (ADF) process.

VI.43 From the graded panels of 'experienced' and 'new' auditors received from the Comptroller and Auditor General of India, 126 audit firms were approved by the Reserve Bank for working as statutory central auditors in PSBs for 2015-16.

VI.44 On direction from the Board for Financial Supervision (BFS), the format for the biennial financial inspection of AIFIs, *viz*., NABARD, Small Industries' Development Bank of India (SIDBI) and National Housing Bank (NHB) was redesigned and snap audits based on this format were carried out to test and fine-tune it. AIFIs were advised to submit returns under both the existing system of FID_OSMOS as well as XBRL platform from the quarter ended June 30, 2015.

VI.45 A new framework for fraud detection, reporting and monitoring was rolled out in May 2015. A Central Fraud Registry for the use of banks was operationalised on January 20, 2016.

VI.46 During the year, as part of cross-border supervisory co-operation and exchange of supervisory information, the Reserve Bank signed MoUs with seven overseas banking supervisory authorities, *viz*., the Nepal Rastra Bank, Bank of Botswana, Central Bank of the United Arab Emirates (UAE), Bangladesh Bank, Prudential Regulation Authority and Financial Conduct Authority of the UK and the supervisor of banks at the Bank of Israel. The Reserve Bank has so far executed 32 MoUs, one letter of supervisory co-operation and one statement of co-operation with overseas supervisors/regulators.

VI.47 To review group-level and inter-regulatory issues in the operations of FCs, the Reserve Bank, in co-ordination with other domestic regulators, organised a meeting with one bank-led FC and participated in meetings with three insurance company-led FCs and securities company-led FCs each organised by IRDA and Securities and Exchange Board of India (SEBI), respectively.

Agenda for 2016-17

VI.48 The Reserve Bank has set up an Expert Panel on IT Examination and Cyber Security (Chairperson: Smt. Meena Hemchandra) drawing experts from the industry as members. The Panel is expected to provide assistance in IT examination/cyber security initiatives of banks, review examination reports and suggest actionable items. Accordingly, a detailed IT examination was initiated in two banks in October and December 2015. It is proposed to roll out the IT examination in 30 major banks during 2016-17. Furthermore, it is proposed to carry out IT examination in all banks by 2017-18. The Reserve Bank also proposes to set up a Cyber Security Lab, which will assist IT examiners in conducting analysis of cyber security of banks.

VI.49 During the supervisory cycle of 2016-17, the remaining 26 banks will be brought under the SPARC framework, thus, bringing all SCBs (excluding regional rural banks (RRBs) and LABs) under the RBS. With the migration of all banks to SPARC in 2016-17, the SPARC framework is proposed to be taken to the next level by: (a) developing risk-based mechanisms for scoring the data quality of banks; (b) improving the off-site risk assessment framework; (c) developing a framework for continuous supervision; (d) developing a menu of supervisory actions based on business risks; (e) benchmarking the control environment in banks; (f) improving the communication of risk profiles to banks; (g) structuring risk mitigation plans to make them more definitive; and (h) finalising the approach for supervising payments banks and SFBs.

VI.50 A back-office support system has been planned to facilitate a focused analysis of data to strengthen the supervision of individual banks. This will also help in an analysis of data dumps obtained from banks in a systematic manner to bring out supervisory concerns, if any. Supervisory returns, other than OSMOS returns, will be taken up for migration to the XBRL platform in Phase III of the XBRL project. All returns relating to frauds will be migrated to the XBRL platform. An audit management system and document management system will be implemented during the year.

VI.51 The Reserve Bank, in coordination with other domestic regulators, has initiated the process of finalising the criteria for identification of FCs in various market segments, *viz*., banking, non-banking finance, insurance business, securities and pension funds. Based on these criteria, FCs will be identified for consolidated supervision and monitoring. A joint working group with representation from all member regulators has been constituted for finalising the format and structure of the draft data template for capturing systemic risks and changes to/rationalisation of FC returns.

VI.52 Changes in the domestic and global financial sector environment necessitate the formalisation of an improved supervisory framework for taking enforcement action against banks for non-compliance with instructions and guidelines issued by the Reserve Bank. Accordingly, the Reserve Bank is in the process of developing a framework, which will delineate its approach to enforcement action and enforcement processes. The framework is intended to meet the principles of natural justice and global standards of transparency, predictability, standardisation, consistency, severity and timeliness of action.

VI.53 In line with the BCBS principles on cross-border supervisory co-operation, the Reserve Bank has set up supervisory colleges for Indian banks with considerable overseas presence, *viz*., State Bank of India (SBI), ICICI Bank, Bank of Baroda, Bank of India, Punjab National Bank and Axis Bank. All these colleges are scheduled to be conducted in 2016-17 as well.

Co-operative Banks: Department of Co-operative Bank Supervision (DCBS)

VI.54 DCBS is entrusted with the primary responsibility of supervising primary (urban) co-operative banks (UCBs) as well as ensuring the development of a safe and well-managed co-operative banking sector. Towards this objective, the Department undertakes supervision of UCBs through periodic on-site and continuous off-site monitoring.

Agenda for 2015-16: Implementation Status

VI.55 In an endeavour to develop a financially sound co-operative banking sector, the number of UCBs with negative net worth, which were not under all-inclusive directions, was reduced from 27 to 18 during the year. All returns received by DCBS were brought on the XBRL platform during the year. In all, 109 programmes were conducted by various Regional Offices of the Reserve Bank to impart training to the management/staff of UCBs and their statutory auditors.

Agenda for 2016-17

VI.56 Towards increasing the strength of the co-operative banking sector, select ‘C’ rated UCBs across India will be identified for focused attention, enabling them to improve their functioning. In addition, the initiatives for capacity building of both supervisor and supervised (UCBs) will be carried forward during the year.

NBFCs: Department of Non-Banking Supervision (DNBS)

VI.57 DNBS – the Reserve Bank’s supervisory department for NBFCs – focuses on ensuring an enabling environment for a healthy NBFC sector. Recent years have witnessed a significant growth of the NBFC sector as also the introduction of newer types of NBFCs imparting a critical role to this Department.

Agenda for 2015-16: Implementation Status

VI.58 For ensuring better coordination among various regulators and gathering market intelligence, a website, hosted by the Reserve Bank was operationalised during the year for use by state-level coordination committees (chaired by the chief secretaries of state governments). A CRILC platform to furnish information on large borrowers was made active during the year for eligible NBFCs. A consultative approach involving regular interaction with participants from the NBFC sector was formalised and meetings were organised accordingly. During the year, a simplified annual return was prescribed for small NBFCs.

VI.59 During 2015-16, ARCs continued to be active in the takeover of stressed assets from banks (Table VI.1).

Agenda for 2016-17

VI.60 During the year, it is proposed to review the role of statutory auditors in the certification process so as to have a wider supervisory oversight of a large number of small NBFCs. The process of leveraging IT for processing of necessary approvals by the Reserve Bank, which has been initiated, will be taken forward during the year. Furthermore, compliance of NBFCs with the Fair Practices Code is set to be improved through enhanced supervision. A formal PCA framework will be developed for NBFCs.

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

(₹ billion)

Item	2014-15	2015-16
1	2	3
Owned funds	33.6	36.8
Acquisition cost of assets acquired by SCs/RCs	226.5	142.2
Total SRs issued	224.3	140.9
SRs held by SCs/RCs in own account	29.8	20.5
SRs held by seller banks/FIs	191.7	117.7
Amount of SRs issued to other QIBs	2.8	0.6
SRs held by FIIs	-	2.1
SRs redeemed	16.5	19.1

Note: 1. SRs: Security Receipts; QIBs: Qualified Institutional Buyers; FIIs: Foreign Institutional Investors.
2. Figures for owned funds are as at end-March.

Source: COSMOS returns (quarterly).

CONSUMER EDUCATION AND PROTECTION

Consumer Education and Protection Department (CEPD)

VI.61 As the financial sector grows in size, depth and complexity, ensuring consumer protection assumes a key priority for the financial sector regulator. The Reserve Bank, through its proactive policy measures directly aimed at consumer protection along with its constant vigil of overall financial stability has rendered the financial system a safer place for consumers over the years.

Agenda for 2015-16: Implementation Status

Full-fledged Operationalisation of the Charter of Customer Rights

VI.62 In 2014-15, the Reserve Bank had issued the Charter of Customer Rights. To ensure its full-fledged operationalisation, banks were advised to formulate with the approval of their respective boards, a Customer Rights Policy on the lines of the Model Policy developed by the Indian Banks' Association (IBA) and the Banking Codes and Standards Board of India (BCSBI). In 2015-16, apart from an internal periodic review, banks were advised that aberrations and non-adherence to the Charter would also be monitored during the supervisory process.

Comprehensive Review of the Banking Ombudsman (BO) Scheme

VI.63 A comprehensive review of the BO scheme was undertaken in 2015-16 (Box VI.6). Towards expanding the reach of the offices of the Banking Ombudsman (OBOs) in rural and semi-urban areas as also for rationalising the jurisdiction of

Box VI.6
Banking Ombudsman Scheme – A Review

The BO scheme – a dispute redressal mechanism notified under Section 35(A) of the Banking Regulation Act, 1949 – has been in existence since 1995. Since its inception, the scheme has been reviewed periodically; the last being in 2009. The banking landscape has undergone significant transformation in recent years with the introduction of a large customer base following the adoption of financial inclusion plans as well as the PMJDY. There has also been an increased penetration of technology-based products for financial inclusion during this period. All these developments taken together necessitated a review of the BO scheme. The issues identified for the current review were:

a. Pecuniary jurisdiction of the award passed by the BO;

b. Compensation available under the present scheme for loss of time and money, mental anguish and harassment of the complainant;

c. Inclusion of additional grounds for complaints under the present scheme;

d. Rationalisation of the clauses provided for rejection of complaints by the BO and inclusion of the clauses as appealable under the scheme; and

e. Rationalisation of Clause 11 of the scheme (Settlement of Complaint by Agreement).

It is proposed to notify the revised scheme after concurrence from the Government of India.

some of the existing offices, new OBOs are being opened in Ranchi, Raipur, Jammu and Dehradun, and an additional BO is being posted in New Delhi.

Field-level Evidence on Consumer Protection and Internal Ombudsman in Banks

VI.64 The Reserve Bank has been conducting focused studies on various issues relevant for consumer protection. In 2015-16, *incognito* visits to rural and semi-urban areas with regard to mis-selling of third party products by banks were carried out. Similarly, a study on the functioning of ATMs was conducted during February-March 2016. The findings from this study are under examination to ascertain an appropriate supervisory response.

VI.65 With a view to strengthening the internal grievance redressal mechanism of banks as also ensuring limited escalation of complaints to the BO, the Reserve Bank advised all PSBs, select private banks and foreign banks to appoint chief customer service officers (CCSO – internal ombudsman). Accordingly, all concerned banks appointed CCSOs and operationalised their functioning during the year.

Enhancing Awareness

VI.66 Against the backdrop of a large number of complaints about fictitious offers of money, a month-long awareness campaign through All-India radio /FM radio was undertaken to sensitise and caution the public not to fall prey to such offers made in the name of the Reserve Bank or any other public authority.

Standardisation of Forms

VI.67 As basic application forms vary from bank to bank posing avoidable hindrance to customers, the Reserve Bank in consultation with IBA reviewed the commonly used forms and suggested standardisation of select forms. Banks will be shortly advised through IBA to implement the standardised forms.

Agenda for 2016-17

VI.68 The Reserve Bank will monitor the implementation of the Charter of Customer Rights by banks, undertake full-fledged implementation of the amended BO scheme and work towards the operationalisation of new OBOs. More forms commonly used by bank customers will be standardised across banks during the year. Setting up of an appropriate ombudsman scheme for the NBFC sector is also on the agenda. Need-based studies through *incognito* visits to bank branches on various customer service issues will be undertaken to assess the field-level situation. Based on the assessment, an appropriate regulatory or supervisory response will be designed.

Deposit Insurance and Credit Guarantee Corporation (DICGC)

VI.69 Deposit insurance is central to the framework for consumer protection in a financial system. In India, DICGC – a wholly-owned subsidiary of the Reserve Bank – insures depositors of all commercial banks, including LABs and RRBs, and co-operative banks. With the present limit of deposit insurance of ₹0.1 million, the total number of fully protected accounts was 1,553 million as on March 31, 2016, which constituted 92.3 per cent of the total number of accounts (1,682 million) as against the international benchmark of 80 per cent. The amount of insured deposits was ₹28,264 billion as at end-March 2016, which worked out to 30 per cent of the assessable deposits (of ₹94,053 billion) well within the international benchmark of 20-30 per cent.

VI.70 The corpus of the deposit insurance fund (DIF) built by DICGC through surplus transfers was ₹602.5 billion as on March 31, 2016. The fund is used for settlement of claims of depositors of banks taken into liquidation/reconstruction/amalgamation. In 2015-16, the claims settled by the Corporation amounted to ₹0.47 billion as compared to ₹3.2 billion in the previous year. In September 2015, the Committee on Differential Premium System for Banks in India (Chairman: Shri Jasbir Singh) submitted its report. In the light of the Committee's report, the modalities for a differential premium system based on risk profiles of banks are being worked out.

VI.71 The key areas of focus in 2016-17 will be enhancing public awareness about deposit insurance and revamping the website of DICGC towards achieving this objective; ensuring intensive co-operation with the International Association of Deposit Insurers (IADI) and making efforts to adhere to Core Principles for Effective Deposit Insurance Systems.

Integrated Application Software Solution

VI.72 The integrated application software solution (IASS) was initiated in 2015-16 to have a cross-functional and seamless integration of all existing functions of the Corporation. This system will also enable the processing of claims by reducing manual intervention as well as online submission of deposit insurance returns.

National Housing Bank (NHB)

VI.73 NHB – the apex institution for housing finance – registers, regulates and supervises housing finance companies (HFCs). It also extends refinance to HFCs, SCBs and co-operative sector institutions against their housing loans, and project lending to borrowers in the public sector and public-private space. Over the years, NHB's key concern has been to promote innovative market-based solutions for affordable housing finance to low income housing segments. The Reserve Bank contributed ₹10 billion towards the paid-up capital of NHB on January 12, 2016, thereby increasing its shareholding from ₹4.5 billion to ₹14.5 billion.

VI.74 Out of the total refinance of ₹215.9 billion extended by NHB in 2015-16 (July-June), 17.4 per cent (₹37.5 billion) was made under the rural housing fund (RHF) and 6.4 per cent (₹13.8 billion) under the urban housing fund (UHF). The central government has identified NHB as the nodal agency for implementing the credit-linked subsidy scheme (CLSS) under the Pradhan Mantri Awas Yojana (Urban) – Housing for All Mission, and the solar capital subsidy scheme. As part of CLSS, NHB released subsidy claims of ₹1.2 billion pertaining to 7,062 households to 57 primary lending institutions till end-June 2016.

VI.75 NHB also extended refinance to HFCs at reduced rates under the Urban Housing Fund scheme to step up the flow of housing finance to flood-affected districts of Tamil Nadu. As at end-June 2016, ₹440 million was disbursed as part of this scheme. NHB launched RESIDEX in July 2007 for tracking residential property prices across 26 cities in India on a quarterly basis. After a recent review of the index, it was decided to revamp it by bringing out comprehensive housing-related indices.