

VI

REGULATION, SUPERVISION AND FINANCIAL STABILITY

Preserving financial stability while continuing to build a resilient and stable financial system took a centre stage in the year 2020-21, even as alleviating stress in various sectors of the economy and segments of the financial sector assumed importance as the year was marked with ravages of the COVID-19 pandemic. Accordingly, while several regulatory and supervisory measures were undertaken in response to the outbreak of the pandemic to address transient issues, in alignment with the long-term objective, the regulatory and supervisory framework was streamlined across regulated/supervised entities and strengthened, to maintain conformity with global best practices. Harnessing technology for customer services, strengthening fraud detection and consumer protection were also pursued as concurrent objectives. Capacity building of the personnel dealing with supervision, regulation, financial stability and enforcement functions was prioritised.

VI.1 The chapter discusses regulatory and supervisory measures undertaken during the year to strengthen the financial system and preserve financial stability. As part of the overall objective of aligning the regulatory/supervisory framework with global best practices, important strides in the areas of corporate governance, cyber security and compliance functions in banks were made. Steps towards developing a robust securitisation and secondary loan market in India were undertaken. Regional Rural Banks (RRBs) were provided additional avenues for liquidity management. The process of submitting statutory returns and supervisory disclosure by banks witnessed further automation.

VI.2 In other areas, consequent to transfer of regulation of housing finance companies (HFCs) from National Housing Bank (NHB) to the Reserve Bank with effect from August 9, 2019, the regulatory framework for the HFCs was comprehensively reviewed after a consultation process with the stakeholders and a revised regulatory framework was put in place in October 2020. As part of this, definition of housing finance business was introduced and principal business criteria were laid down with timelines for its phased introduction

for entities to qualify as non-banking financial company-HFCs (NBFC-HFCs), failing which the entities were to be treated as NBFC-Investment and Credit Companies (NBFC-ICCs). Instructions were also provided for enhancing net owned fund (NOF) and for the phased introduction of Liquidity Risk Management Framework (LRM) and Liquidity Coverage Ratio (LCR). The guidelines also covered loan-to-value (LTV) requirements and levy of foreclosure charges. With these changes HFC regulations were harmonised with the regulations for other NBFCs to some extent. With the revised framework, the foundation has been provided for an orderly growth of the housing finance in pursuit of economic and social objectives, especially as the housing construction and housing markets have a multiplier effect on economic activity and job creation. Their sound regulation is, nevertheless, important as the sector is known to have caused booms and bust with ripple effects for the rest of the economy.

VI.3 The Reserve Bank had reviewed the guidelines for core investment companies (CICs) earlier in August 2020, taking into account the recommendations of the Working Group chaired by Shri Tapan Ray. Under the revised guidelines,

in computing Adjusted Net Worth (ANW), the direct or indirect capital contribution made by one CIC in another CIC, in excess of 10 per cent of owned funds of the investing CIC, is to be deducted. Given the earlier experience with the opacities of the complex CIC structures evading regulation and supervision, the Reserve Bank also addressed the complexity in group structures and existence of multiple CICs within a group by restricting the number of layers of CICs within a Group (including the parent CIC) to two, irrespective of the extent of direct or indirect holding/control exercised by a CIC in the other CIC. Several other regulatory guidelines, including those on corporate governance and disclosures were also laid down.

VI.4 During the year, the Reserve Bank continued with its endeavour of strengthening the supervisory framework of the scheduled commercial banks (SCBs), urban cooperative banks (UCBs) and NBFCs. The Reserve Bank has strengthened its off-site supervisory framework for identifying risks early by using various tools. This has been complemented by creating a graded supervisory action framework, so as to enable early stage supervisory action, which is critical to prevent vulnerabilities from escalating or becoming acute. Accordingly, the supervisory approach of the Reserve Bank is now more forward looking, root-cause oriented, and incorporating both quantitative and qualitative elements into supervisory assessments. Significant initiatives were taken towards furthering specialisation and addressing the issue of asymmetry of information by way of: a) integration of supervisory functions meant for different supervised entities (SEs); b) specialisation and reinforcement of supervision through both vertical and horizontal risk assessments, and c) setting up a dedicated College of Supervisors (CoS) for capacity development. While continuing the efforts to strengthen the

supervisory function, actions are also being taken to harness supervisory technology (SupTech).

VI.5 In the cooperative banking space, amendment in Banking Regulation (BR) Act, 1949 (as applicable to cooperative societies) not only improved Reserve Bank's regulatory powers over cooperative banks, but also paved the way for improving the governance and functioning of UCBs. Other major developments during the year included adoption of a calibrated supervisory approach for UCBs.

VI.6 The rest of this chapter is divided into five sections. Section 2 deals with the mandate and functions of the Financial Stability Unit (FSU). Section 3 addresses various regulatory measures undertaken by the Department of Regulation (DoR). Section 4 covers several supervisory measures undertaken by the Department of Supervision (DoS), and enforcement actions carried out by the Enforcement Department (EFD) during the year. Section 5 highlights the role played by the Consumer Education and Protection Department (CEPD) and the Deposit Insurance and Credit Guarantee Corporation (DICGC) in protecting consumer interests, spreading awareness and upholding consumer confidence. The departments have also set out agenda for 2021-22 in their respective sections. Concluding observations are set out in the last section.

2. FINANCIAL STABILITY UNIT (FSU)

VI.7 The mandate of the Financial Stability Unit (FSU) is to monitor the stability and soundness of the financial system by examining risks to financial stability, undertaking macro-prudential surveillance through systemic stress tests, undertaking financial network analysis and by disseminating early warning information through the Financial Stability Report (FSR). It also functions as a secretariat to the Sub-Committee of the Financial Stability and Development

Council (FSDC), an institutional mechanism of regulators for maintaining financial stability and monitoring macro-prudential regulation in the country.

Agenda for 2020-21: Implementation Status

Goals Set for 2020-21

VI.8 The Department had set out the following goals for 2020-21:

- Strengthening the stress testing framework/methodology by incorporating evolving best practices (*Utkarsh*) [Para VI.9];
- Publishing the FSR on a timely basis with state of play analysis (Para VI.10);
- Conducting macro-prudential surveillance (Para VI.11); and
- Conducting meetings of the FSDC Sub-Committee (FSDC-SC) [Para VI.12 - VI.13].

Implementation Status of Goals

VI.9 As part of strengthening the stress testing framework, latest international practices were reviewed. Possible channels of feedback in the macro-stress environment were identified.

VI.10 The December 2020 issue of the FSR was published on January 11, 2021, rescheduled to incorporate the first advance estimates of national income for 2020-21, released by the National Statistical Office on January 7, 2021. The FSR reflected the collective assessment of the FSDC-SC on the balance of risks around financial stability. The FSR highlighted the active intervention of central banks and fiscal authorities across the world to stabilise financial markets, risks of spillovers and macro-financial implications, the disconnect between financial markets and real sector activity, profitability and capital adequacy of banks with some moderation in balance sheet stress and still subdued bank credit.

VI.11 Macro stress tests indicated a deterioration in scheduled commercial banks' (SCBs) asset quality and capital buffers under adverse scenarios. The regular macro-stress testing framework of the Department was augmented to capture the underlying state of banks' portfolios under the cover of regulatory forbearances.

VI.12 In its meeting held on August 31, 2020, the FSDC-SC reviewed major developments in global and domestic macroeconomic conditions and in financial markets impinging on financial stability; and undertook discussions related to inter-regulatory coordination and review of the initiatives and activities of National Centre for Financial Education (NCFE). In the meeting held on January 13, 2021, the Sub-Committee, *inter alia*, discussed scope for improvements in insolvency resolution under the Insolvency and Bankruptcy Code (IBC), 2016, utilisation of data with the Central Know Your Customer (KYC) Records Registry and changes in the regulatory framework relating to Alternative Investment Funds (AIFs) set up in the International Financial Services Centre (IFSC), among others. In these meetings, the Sub-Committee also reviewed the activities of various technical groups under its purview and the functioning of State Level Coordination Committees (SLCCs) in various states/union territories (UTs). The regulators reaffirmed their commitment to continue coordinating on various initiatives and measures to strengthen the financial sector in the extraordinarily challenging times.

Impact of COVID-19 Pandemic

VI.13 The FSU is primarily entrusted with macro-prudential surveillance and the smooth functioning of the FSDC-SC. The imposition of the lockdown and challenges in terms of restricted access to databases, information systems and software were overcome through remote access and virtual interactions, including in case of the FSDC-SC meetings.

Agenda for 2021-22

VI.14 In the year ahead, FSU will focus on the following:

- Strengthening the stress testing framework/methodology by incorporating evolving best practices (*Utkarsh*);
- Conducting macro-prudential surveillance;
- Publishing the FSR on a timely and updated basis; and
- Conducting meetings of the FSDC-SC.

3. REGULATION OF FINANCIAL INTERMEDIARIES

Department of Regulation (DoR)

Commercial Banks

VI.15 The Department of Regulation (DoR) is the nodal Department for regulation of commercial banks for ensuring a healthy and competitive banking system, which provides cost effective and inclusive banking services. The regulatory framework is fine-tuned as per the requirements of the Indian economy while adapting to international best practices.

Agenda for 2020-21: Implementation Status

Goals Set for 2020-21

VI.16 The Department had set out the following goals under *Utkarsh* for regulation of commercial banks in 2020-21:

- *Convergence of the Reserve Bank's Regulations with Basel III Standards:* Draft guidelines on credit risk and market risk would be issued, in conformity with Basel III standards, along with the final guidelines on Interest Rate Risk in Banking Book (IRRBB); draft guidelines on minimum capital requirements for operational risk under Basel III

standardised approach (SA) will also be issued. However, to free up banks and supervisors to respond to economic impact of COVID-19 pandemic, the Basel Committee on Banking Supervision (BCBS) has deferred the implementation of Basel III standards by one year to January 1, 2023 (Para VI.17-18).

Implementation Status of Goals

Convergence of the Reserve Bank's Regulations with Basel III Standards

VI.17 The Basel committee's oversight body - the Group of Central Bank Governors and Heads of Supervision (GHOS) - has endorsed a set of measures to provide additional operational capacity for banks and supervisors to respond to the immediate financial stability priorities resulting from the impact of COVID-19 pandemic on the global banking system. One of the measures already endorsed by the GHOS on March 27, 2020 was to defer the timeline for implementation of Basel III standards from January 1, 2022 to January 1, 2023.

VI.18 The target date for issuance of draft Basel III guidelines on credit, market and operational risk, as also final guidelines on interest rate risk in banking book has been deferred to September 2021.

Major Developments

Revised Guidelines on Securitisation and Sale of Loan Exposures

VI.19 Draft framework on securitisation, issued on June 8, 2020 for public comments, is being examined and the final guidelines will be issued shortly. Aimed at development of a strong and robust securitisation market in India, while incentivising simpler, transparent and comparable (STC) securitisation structures,

the revised guidelines attempt to align the regulatory framework with the Basel guidelines on securitisation that have come into force effective January 1, 2018. The revisions also take into consideration the recommendations of the Committee on Development of Housing Finance Securitisation Market in India (Chair: Dr. Harsh Vardhan) and the Task Force on the Development of Secondary Market for Corporate Loans (Chair: Shri T. N. Manoharan), which were set up by the Reserve Bank in May 2019.

VI.20 Apart from reviewing the securitisation guidelines, it was also decided to comprehensively revisit the guidelines for sale of loan exposures, stressed as well as those not in default, which are currently spread across various circulars, and accordingly a draft comprehensive framework for sale of loan exposures was released on June 8, 2020. These guidelines on sale of loan exposures have been specific to the asset classification of the loan exposure being transferred and/or the nature of the entity to which such loan exposure is being transferred as well as the mode of transfer of the loan exposures. A review was also necessitated by the need to dovetail the guidelines on sale of loan exposures with the Insolvency and Bankruptcy Code (IBC), 2016 and the Prudential Framework for Resolution of Stressed Assets, which have been significant developments towards building a robust resolution paradigm in India in the recent past. Further, based on the recommendations of the above-mentioned task force, it was announced in the Statement on Developmental and Regulatory Policies of December 5, 2019 that the Reserve Bank will facilitate the setting up of a self-regulatory body - Secondary Loan Market Association (SLMA) - that was then registered on August 26, 2020. SLMA is currently examining the various measures for the development of the

secondary loan market, including standardisation of loan documentation and loan sales platform.

Opening of Current Accounts by Banks

VI.21 With a view to ensuring credit discipline, instructions were issued on August 6, 2020 on the manner of opening of cash credit/overdraft (CC/OD) and collection/current accounts with banks depending upon the aggregate credit exposure of the banking system to a borrower. In case of customers who have not availed any credit facilities from the banking system, there are no restrictions on opening of such accounts. Further, banks have been permitted *vide* circular dated December 14, 2020, to open activity-specific accounts without restrictions, if mandated under various statutes/instructions issued by various regulators including the Reserve Bank.

Regulatory Retail Portfolio - Revised Limit for Risk Weight

VI.22 In order to reduce the cost of credit for the regulatory retail segment consisting of individuals and small businesses (*i.e.*, with turnover of up to ₹50 crore), as also in harmonisation with the Basel guidelines, the threshold qualifying exposure for inclusion in this segment was increased from ₹5 crore to ₹7.5 crore *vide* circular dated October 12, 2020. Thus, the risk weight of 75 per cent will apply to all fresh exposures and also to existing exposures where incremental exposure may be taken by the banks up to the revised limit of ₹7.5 crore. This measure is expected to increase the much-needed credit flow to the small business segment.

RRBs - Liquidity Adjustment Facility (LAF) and Marginal Standing Facility (MSF)

VI.23 In order to provide an additional avenue for liquidity management, LAF and MSF were extended to scheduled RRBs, subject to meeting certain conditions, on December 4, 2020.

Amalgamation of the Lakshmi Vilas Bank (LVB) Ltd. with DBS Bank India Ltd.

VI.24 The financial position of 'The Lakshmi Vilas Bank (LVB) Ltd.' had undergone a steady decline with the bank incurring continuous losses since 2018, eroding its net worth. Absence of any viable strategic plan, declining advances, mounting non-performing assets, failure to raise capital or bring a strategic investor, regular outflow of liquidity and serious governance issues necessitated the Reserve Bank to take immediate action in the public interest and particularly in the interest of the depositors. Accordingly, on November 17, 2020, the Central Government imposed moratorium on LVB Ltd. up to December 16, 2020 and the Reserve Bank superseded the Board of Directors and appointed an Administrator. The Central Government accorded its sanction to the scheme of amalgamation and notified the 'Lakshmi Vilas Bank Ltd. (Amalgamation with DBS Bank India Ltd.) Scheme 2020' on November 25, 2020, which came into effect on November 27, 2020.

Submission of Statutory Returns by SCBs in Electronic Form on eXtensible Business Reporting Language (XBRL) Live Site

VI.25 To improve efficiency of submission of statutory returns while doing away with the drudgery of physical submission and cost of logistics involved, thereby reducing carbon footprints, it has been decided to dispense with the practice of submission of hard copy of Form A (CRR) and Form VIII (SLR), with effect from reporting Friday August 28, 2020. The SCBs have been advised to submit these returns in electronic form on XBRL live site using digital signatures of two authorised officials.

Regulatory Response to COVID-19 Pandemic

VI.26 The regulatory measures initiated in response to the outbreak of pandemic are reviewed on an ongoing basis. Further, additional measures have been taken or existing measures have been fine-tuned depending upon the prevailing situation at the time of such reviews. These measures were broadly in line with the cross-country regulatory response to the pandemic (Box VI.1).

Box VI.1

COVID-19 Related Regulatory Measures - A Cross-country Perspective

During 2020-21, the global central banks and governments have taken extraordinary measures to mitigate the economic and financial spillover risks from the COVID-19 pandemic. Central banks in all geographies responded swiftly and deployed all options available in their toolkit, both conventional and unconventional, to support their economies. The universally used measures were policy rate reductions and provision of domestic and foreign exchange liquidity. Where the banking system is concerned, banks in general had higher capital before the onset of the COVID-19 pandemic than what they had before the global financial crisis (GFC), enabling the authorities to deploy an array of policies to support economic activity, ability of banks to lend and aid recovery. At the Bank for International Settlements (BIS), a group of central bank Governors and heads of supervision endorsed a gamut of measures to enhance the operational capacity of banks' supervisors to

respond to the immediate financial stability priorities. The implementation dates of the Basel III standards, the revised Pillar 3 disclosure requirements and the revised market risk framework have been deferred by one year to January 1, 2023. Basel Committee on Banking Supervision (BCBS) amended its transitional arrangements for the regulatory capital treatment of expected credit losses (ECL) accounting to give countries more flexibility on the manner of phasing in ECL on regulatory capital. Some actions in the area of prudential regulation are summarised below:

Moratorium and Asset Classification Guidance: Many countries (such as Argentina, Brazil, China, India, France, Hong Kong, the United States - US, and the United Kingdom - UK) provided guidance on restructuring of existing loans stressed due to the pandemic and also indicated that

(Contd.)

loans that were granted a repayment deferral need not be regarded as restructured. Some authorities provided that a moratorium does not trigger automatic loan reclassification as 'default' for supervisory reporting purposes. In some countries like India, the payment moratorium period was to be excluded from the number of days past due for the purpose of asset classification.

Basel III Capital and Liquidity Buffers: Many authorities (such as Australia, Canada, Switzerland, Germany, Euro Area, Japan, Hong Kong, Korea, Mexico, Russia, Singapore, the UK, and the US) have encouraged or more forcefully recommended financial institutions to use their capital and liquidity buffers to support lending. The BCBS has also clarified that a measured drawdown of banks' Basel III buffers is anticipated and appropriate in the current period of stress. The liquidity buffers like the Liquidity Coverage Ratios (LCR) were temporarily eased in many countries (e.g., India, Indonesia, the UK, Brazil and Sweden). A number of jurisdictions (such as Switzerland, Germany, France, Sweden, and the UK) decided to lower or reduce the countercyclical capital buffer (CCyB) to zero. The UK gave clear guidance that the buffer will remain at that level for at least 12 months. Some countries reduced the CCyB partially (Hong Kong). A few others temporarily reduced other types of capital buffers, such as for domestic systemically important banks or the capital conservation buffer (CCB). In India, the date of implementation of the last tranche of CCB (0.625 per cent) was deferred.

Leverage: A number of authorities (such as Canada, Switzerland, and the US) have temporarily modified the

leverage ratio rule to exclude reserves or deposits at the central bank from calculation without commensurate recalibration of the minimum leverage ratio requirement. Some countries have also excluded government bond holdings from banks' leverage exposure on a temporary basis to facilitate large asset purchase programmes.

Restraining Dividend Pay-outs: Measures were taken to conserve the capital levels in banks through restrain on dividend distributions and on share buybacks either by regulation or strong administrative guidance, imposed in numerous countries (such as Argentina, Australia, Brazil, Canada, Switzerland, Germany, Euro Area, India, Mexico, Russia, Sweden, Singapore, the UK, and South Africa). Some prudential and regulatory authorities recommended that banks should suspend the payment of dividends and share buybacks until end 2020 or even cancel outstanding 2019 dividends (Prudential Regulatory Authority, the UK).

A summary of cross-country measures is provided in Table 1. It can be seen that the central banks in the emerging market economies have deployed almost all tools pertaining to prudential rules and regulations; and liquidity and lending that the advanced economies central banks employed. However, the advanced economies central banks have been more prolific in the use of asset purchases/sales and forex swaps. Besides these measures, in EU, UK and India, the regulatory authorities have allowed delay in submission of different regulatory reports/financial statements during COVID-19 outbreak.

Table 1: Measures Taken by Central Banks during COVID-19 Pandemic

Type of Tool		Prudential Rules and Regulations			Liquidity and Lending		Asset Purchases/Sales			FX Swap
Measures		Capital Requirements	Liquidity Requirements	Payout Restrictions	Liquidity Measures	Specialised Lending	Government Bonds	Commercial Paper	Corporate Bond	USD Swap Line
Advanced Economies	US	✓	✓		✓	✓	✓	✓	✓	
	EA	✓	✓	✓	✓	✓	✓	✓	✓	✓
	JP	✓	✓		✓	✓	✓	✓	✓	✓
	GB	✓	✓	✓	✓	✓	✓	✓	✓	✓
	CA	✓	✓	✓	✓		✓	✓	✓	✓
	AU	✓	✓	✓	✓	✓	✓			✓
	CH	✓	✓	✓		✓				✓
Emerging Market Economies	BR	✓	✓	✓	✓	✓				✓
	CN	✓	✓		✓	✓				
	ID	✓	✓	✓	✓		✓			
	IN	✓	✓	✓	✓	✓	✓			
	KR	✓	✓	✓	✓	✓	✓	✓	✓	✓
	MX	✓	✓	✓	✓	✓				✓
	ZA	✓	✓	✓	✓	✓	✓			

US: United States

EA/EU: Euro Area

JP: Japan

GB: Great Britain

CA: Canada

AU: Australia

CH: Switzerland

BR: Brazil

CN: China

ID: Indonesia

IN: India

KR: Korea

MX: Mexico

ZA: South Africa

Source: BIS, RBI and other Central Banks' websites.

VI.27 A list of the regulatory measures taken in response to the outbreak of the pandemic, are summarised below. Going forward, the regulatory response will continue to be calibrated in response to the evolving situation, based on an assessment of the likely economic impact, a review of the efficacy of previous measures and the objective to preserve soundness:

- *Distressed Assets Fund - Subordinate Debt for Stressed Micro, Small and Medium Enterprises (MSMEs)*: Banks were permitted *vide* circular dated July 1, 2020 to reckon the funds infused by the promoters in their MSME units through loans availed under the government's credit guarantee scheme for subordinate debt for stressed MSMEs as equity/quasi equity from the promoters for purpose of debt-equity computation.
- *Resolution Framework for COVID-19 Pandemic Related Stress*: Instructions were issued on August 6, 2020 through which a window under the Prudential Framework on Resolution of Stressed Assets, issued on June 7, 2019, was provided enabling the lenders to implement a resolution plan in respect of eligible corporate exposures without change in ownership and personal loans, while classifying such exposures as standard, subject to specified conditions. The Resolution Framework was to be invoked till December 31, 2020 and the resolution plan had to be implemented within 90 days (personal loans) and 180 days (other eligible loans) from the date of invocation. Further, the recommendations of the expert committee constituted under the framework were issued on September 7, 2020. A list of frequently asked questions (FAQs) was also released based on the queries received on the resolution framework.
- *MSME Sector - Restructuring of Advances*: Existing loans to MSMEs where the banks, AIFIs and NBFCs have aggregate exposure of not more than ₹25 crore and are classified as 'standard' as on March 1, 2020, were permitted to be restructured without a downgrade in the asset classification. The restructuring has to be implemented by March 31, 2021. A circular to this effect was issued on August 6, 2020.
- *LTV Ratio for Loans against Gold Ornaments and Jewellery for Non-agricultural Purposes*: To mitigate the economic impact of the COVID-19 pandemic on households, entrepreneurs and small businesses, LTV for loans against pledge of gold ornaments and jewellery for non-agricultural purposes was increased from 75 per cent to 90 per cent. This enhanced LTV was applicable up to March 31, 2021.
- *Individual Housing Loans - Rationalisation of Risk Weights*: As per earlier regulations, claims secured by residential property falling under the category of individual housing loans were assigned differential risk weights based on the size of the loan as well as the LTV. Recognising the criticality of real estate sector in the economic recovery, it was decided as a countercyclical measure to rationalise the risk weights irrespective of the size of the loan amount and accordingly, instructions were issued to banks on October 16, 2020. The risk weights for all new housing loans to be sanctioned on or after October 16, 2020 and up to March 31, 2022 shall be as under (Table VI.1):

Table VI.1: LTV Ratio and Risk Weights

LTV Ratio (Per cent)	Risk Weight (Per cent)
1	2
≤ 80	35
> 80 and ≤ 90	50

- *Large Exposure Framework (LEF):* In terms of LEF guidelines dated June 3, 2019, exposures to Government of India and state governments which are eligible for zero per cent risk weight under the Basel III - capital regulation framework of the Reserve Bank are exempted from LEF limits. On a review and in line with the Basel guidelines, it was decided to exempt exposures to foreign sovereigns or their central banks from LEF that attract zero per cent risk weight, subject to certain conditions. Accordingly, instructions were issued to banks on February 24, 2021. Further, the date of applicability of the LEF guidelines to non-centrally cleared derivative exposures has been deferred to September 30, 2021 *vide* circular dated March 23, 2021.
- In the backdrop of the COVID-19 related challenges, the Reserve Bank took certain other regulatory measures. The implementation of net stable funding ratio (NSFR) guidelines, which were to come into effect from October 1, 2020 onwards, were deferred till October 1, 2021. In order to aid the recovery process in the backdrop of COVID-19 related stress, the implementation of the last tranche of 0.625 per cent of capital conservation buffer (CCB) was also deferred till October 1, 2021. Based on a review and empirical testing of the countercyclical capital buffer (CCyB) indicators, including the credit-to-

GDP gap as a main indicator, activation of the buffer was not found to be necessary.

- After a review of earlier instruction, banks were advised to not make any dividend payment on equity shares from the profits pertaining to the financial year ended March 31, 2020.

Other Initiatives

VI.28 Some of the other initiatives during 2020-21 were as follows:

- A Discussion Paper on 'Governance in Commercial Banks in India' was issued by the Reserve Bank on June 11, 2020 to review the framework for governance in the commercial banks. Based on the feedback received, a comprehensive review of the framework has been done, and a Master Direction on governance will be issued in due course. In the interim, to address a few operative aspects received through such feedback, instructions with regard to the Chair and meetings of the board, composition of certain committees of the board, age, tenure and remuneration of directors, and appointment of the whole-time directors (WTDs) has been issued on April 26, 2021.
- An Internal Working Group (IWG) was constituted to review the extant guidelines on ownership and corporate structure for Indian private sector banks. The IWG has submitted its report with certain recommendations relating to promoters' stake, setting up of new banks by large corporate/industrial houses, conversion of large sized NBFCs into banks, conversion of payments banks (PBs) into small finance banks (SFBs), initial capital requirement for licensing of new banks, Non-Operative

Financial Holding Company (NOFHC) structure for banks and harmonisation in different licensing guidelines. The report was placed on the Reserve Bank's website on November 20, 2020 for comments of stakeholders and members of the public. The comments and suggestions received are under examination.

- The revised guidelines for compensation have come into play from April 1, 2020. Its impact on the compensation structure and practices as well as the performance of the banks shall be subject of enhanced regulatory and supervisory oversight going forward, even while executive compensation practices in banks will be evaluated in the context of differentiation within and between commercial banking segments.

Agenda for 2021-22

VI.29 For the year ending March 31, 2022, the Department will focus on the following key deliverables in respect of the commercial banks:

- Issuing draft guidelines on capital charge for credit risk (SA), market risk, operational risk and output floor, as part of convergence of the Reserve Bank's regulations with Basel III standards;
- Issue of final guidelines on securitisation of assets not in default; and
- Issue of final guidelines on transfer of loan exposures.

Cooperative Banks

VI.30 The Reserve Bank continues to play a key role in strengthening the cooperative banking sector by fortifying the regulatory and supervisory framework. In this context, the Department took several initiatives in 2020-21 in pursuance of the agenda set in the beginning of the year.

Agenda for 2020-21: Implementation Status

Goals Set for 2020-21

VI.31 The Department had set out the following goals for cooperative banks in 2020-21:

- Refinement of the regulatory framework for cooperative banks with a view to strengthening the sector and protecting the interest of the depositors and borrowers (Para VI.32);
- Bringing out a discussion paper on strengthening the regulatory framework for capital adequacy in UCBs (Para VI.33);
- Putting in place a Supervisory Action Framework (SAF) for the state cooperative banks (StCBs) and district central cooperative banks (DCCBs) [Para VI.33]; and
- Faster resolution of weak UCBs which are under All-Inclusive Directions (AID) [Para VI.33].

Implementation Status of Goals

Discussion Paper on Policy Framework for Consolidation of UCB Sector

VI.32 Large number of UCBs are community/region-based which hinders the process of mergers among UCBs and consolidation in the sector. On a proposal made by the Reserve Bank, the BR Act, 1949 (as applicable to co-operative societies) has been amended. Among others, the functions of governance, capital, audit and amalgamation have now been brought under the ambit of the Reserve Bank. An expert committee to provide a road map for strengthening the UCB sector leveraging on the amendments, set up in February 2021, will be, *inter alia*, examining the prospects of consolidation in UCB sector as one of its terms of reference. Further action in the matter will be taken based on the recommendations of the committee.

Strengthening Regulatory Framework

VI.33 Initiatives in this regard during 2020-21 were as follows:

- The amendment in the BR Act, 1949 (as applicable to cooperative societies - AACS) has brought in significant changes in the statutory provisions applicable on cooperative banks. The Department is in the process of amending the extant instructions and issuing new guidelines wherever required.
- The aforesaid amendments in the BR Act would have implications on enhancing the ability of UCBs to raise capital. The expert committee on UCBs will be examining the related issues as one of its terms of reference.
- The draft SAF for StCBs and DCCBs is at the stage of consultation with National Bank for Agriculture and Rural Development (NABARD), being the supervisor of these banks.
- Speeding up the resolution of weak UCBs which are under AID is an ongoing process and the possibilities of using amended provisions of the BR Act are under examination.

Major Developments

System-Based Asset Classification – UCBs

VI.34 In order to improve the efficiency, transparency and integrity of the asset classification process, UCBs with total assets of ₹2,000 crore or above as on March 31, 2020, have been advised to implement the system-based asset classification with effect from June 30, 2021. Further, those UCBs with total assets of ₹1,000 crore or above but less than ₹2,000 crore as on March 31, 2020 and which have self-assessed

themselves as being at Level III or Level IV based on their digital depth and interconnectedness to the payment systems landscape in terms of the circular dated December 31, 2019 on “Comprehensive Cyber Security Framework for UCBs” of the Reserve Bank, have been advised to implement the same with effect from September 30, 2021. Instructions to this effect were issued to UCBs on August 12, 2020.

Submission of Returns under Section 31 of the BR Act, 1949 (AACS) - Extension of time

VI.35 In view of the difficulties faced by cooperative banks in submission of the returns due to the COVID-19 pandemic, the timeline for furnishing the returns under section 31 (read with section 56) of the Act for the financial year ended on March 31, 2020 was initially extended by three months, *i.e.*, till September 30, 2020, and was subsequently further extended till December 31, 2020. Circulars to this effect were issued on August 26 and October 13, 2020, respectively.

Interest Subvention Scheme for MSMEs - Cooperative Banks

VI.36 All cooperative banks were included as Eligible Lending Institutions (ELIs) under the “Interest Subvention Scheme (ISS) for MSMEs 2018” of the Government of India with effect from March 3, 2020. The ISS for MSMEs 2018 (as amended) provides for an interest relief of two per cent per annum to eligible MSMEs on their outstanding fresh/incremental term loan/working capital and limited to the extent of ₹1 crore during the period of its validity, subject to the conditions prescribed in the Scheme.

Loans and Advances to Directors, Relatives, and Firms/Concerns

VI.37 UCBs were advised on February 5, 2021 not to make, provide or renew any loans and advances or extend any other financial

accommodation to or on behalf of their directors or their relatives, or to the firms/companies/concerns in which the directors or their relatives are interested (collectively called as “director-related loans”). Further, the directors or their relatives or the firms/companies/concerns in which the directors or their relatives are interested shall also not stand as surety/guarantor to the loans and advances or any other financial accommodation sanctioned by UCBs.

Voluntary Amalgamation of UCBs

VI.38 On March 23, 2021, the Reserve Bank issued Master Direction on voluntary amalgamation of UCBs under the provisions of Section 44A, read with Section 56 of the Banking Regulation (BR) Act, 1949 as amended *vide* BR (Amendment) Act, 2020 (39 of 2020). The Master Direction lays down the process for the sanction of the Reserve Bank for voluntary amalgamation of two or more UCBs.

Agenda for 2021-22

VI.39 The agenda for cooperative banks in 2021-22 would include the following under *Utkarsh*:

- *Setting up of an Umbrella Organisation (UO) for UCBs*: National Co-operative Finance and Development Corporation Ltd. was incorporated on April 18, 2020 as a non-government public limited company under the Companies Act 2013, having its registered office in New Delhi. The process of enrolment of UCBs as shareholder members of the UO is in progress. The UO is required to apply to the Reserve Bank for obtaining certificate of registration as NBFC; and
- *Discussion Paper on Consolidation of UCB Sector*: An expert committee on UCBs set up in February 2021 is examining, *inter*

alia, the prospects of consolidation in UCB sector as one of its terms of reference. Further action in the matter will be taken based on the recommendations of the committee.

Non-Banking Financial Companies (NBFCs)

VI.40 NBFCs play an important role in providing credit by complementing the efforts of commercial banks, providing last mile financial intermediation and catering to niche sectors. The Department is entrusted with the responsibility of regulating the NBFC sector.

Agenda for 2020-21: Implementation Status

Goals Set for 2020-21

VI.41 The Department had set out the following goals in respect of NBFCs in 2020-21:

- *Review of Regulatory Arbitrage between Banks and NBFCs* - with a view to harmonise the regulations of NBFCs with those of banks (*Utkarsh*) [Para VI.42];
- *Scale-based Approach to Regulation of NBFCs* - with a view to identify a small set of ‘systemically significant’ NBFCs, which can potentially impact financial stability as also to adopt a graded regulatory framework for the NBFCs (Para VI.42);
- *Issuance of Master Directions for HFCs* - proposals for defining the term housing finance, introduction of principal business criteria, qualifying assets for HFCs and classification of HFCs as systemically important were placed on the Reserve Bank’s website on June 17, 2020 for public comments and, the revised regulations were issued based on receipt of comments (Para VI.43 - VI.44); and

- **Comprehensive Review of CIC Guidelines** - in view of the failure of a CIC and its adverse impact on the non-banking financial sector, the Reserve Bank constituted a Working Group (WG) to review the regulatory and supervisory framework of CICs, whose recommendations are set to shape the overall policy approach to CICs (Para VI.45).

Implementation Status of Goals

Review of Regulatory Arbitrage between Banks and NBFCs; and Scale-based Approach to Regulation of NBFCs

VI.42 A discussion paper titled 'Revised Regulatory Framework for NBFCs - A Scale-based Approach' was issued for public comments on January 22, 2021 (Box VI.2). This discussion

Box VI.2

Revised Regulatory Framework for NBFCs - A Scale-Based Approach

Over the years, NBFC sector has undergone considerable evolution. Higher risk appetite of NBFCs has contributed to their size, complexity and interconnectedness making some of these entities systemically significant, posing potential threat to financial stability.

In this overall context, the Reserve Bank has released a discussion paper on *Revised Regulatory Framework for NBFCs - A Scale-Based Approach*. Aimed at development of a strong, well governed and resilient NBFC sector, the discussion paper proposes a scale-based regulatory framework, founded on the principle of proportionality. The degree of regulatory/supervisory interventions will depend on the risk inherent in the operation of an NBFC and the extent of spillover risks it is likely to pose to the financial system. The proposed regulatory framework would place NBFCs into various layers based on the need for differentiated regulations for NBFCs falling in each layer.

The **lowest layer** will comprise NBFCs currently classified as non-systemically important non-deposit taking NBFCs (NBFC-ND). The threshold for NBFCs falling in the layer will be raised to ₹1,000 crore. Additionally, certain NBFCs considered to be inherently less risky in their operations will fall in this layer, including peer-to-peer lending platforms, NBFC-account aggregators, non-operative financial holding companies and type I NBFCs. NBFCs in this layer will continue to be governed by extant regulations applicable for NBFC-ND. However, the regulatory framework would be supplemented by enhanced governance and disclosure standards.

The **middle layer** will consist of systemically important non-deposit taking NBFCs (NBFC-ND-SI) and deposit taking NBFCs (NBFC-D). In addition, a few other types

of NBFCs, such as housing finance companies (HFCs), infrastructure finance companies, infrastructure debt funds, standalone primary dealers (SPDs) and core investment companies (CICs) will also feature in this layer on the basis of their activity. These NBFCs shall be subject to regulatory structure as applicable for NBFC-ND-SI and NBFC-D at present. However, adverse regulatory arbitrage *vis-à-vis* banks is proposed to be addressed in order to reduce systemic risk spillovers, where required. Though CICs and SPDs will fall in the middle layer of the regulatory pyramid, the existing regulations specifically applicable to them, will continue to prevail.

The **upper layer** will consist of only those NBFCs which are specifically identified as systemically significant among NBFCs, based on a set of parameters, *viz.*, size, interconnectedness, complexity and supervisory inputs. In addition to the regulations applicable to the previous layer, a set of additional regulations will apply to these NBFCs. In view of their large systemic significance and scale of operations, the regulation of these NBFCs will be tuned on similar lines as those for banks, while providing for the unique business model of the NBFCs as also preserving flexibility of their operations. Some of the proposed regulatory provisions for these NBFCs include mandatory listing, introduction of common equity tier 1 and certain aspects of large exposure framework.

It is possible that considered supervisory judgment might push some NBFCs out of the upper layer of the systemically significant NBFCs for higher regulation/supervision. These NBFCs will occupy the top layer as a distinct set. Ideally, this top layer of the pyramid will remain empty unless supervisors take a view on specific NBFCs.

Source: RBI.

paper debates the need of revisiting the broad principles underpinning the current regulatory framework of NBFCs and examines the necessity for developing a regulatory framework for scale-based regulation linked to systemic risk contribution of NBFCs. Besides recommending appropriate regulatory measures to create a strong and resilient non-banking financial sector, the extant regulatory areas of arbitrage between banks and NBFCs have also been examined in the paper with a view to harmonise the regulations of NBFCs with those of banks, wherever appropriate.

Issuance of Master Directions for HFCs

VI.43 On the basis of review of regulatory framework for HFCs and examination of public comments on the consultation document released on June 17, 2020, a revised regulatory framework for HFCs was issued on October 22, 2020. It, *inter alia*, includes definition of 'principal business' and 'housing finance'; increase in net owned fund (NOF) requirement to ₹20 crore; restrictions on exposures to group companies engaged in real estate business; extension of applicable regulations for NBFCs on liquidity risk management framework; and guidelines on liquidity coverage ratio (LCR), securitisation, outsourcing of financial services and lending against collateral of gold jewellery/ shares and foreclosure charges to HFCs. Further harmonisation between regulations of HFCs and NBFCs relating to capital requirement; income recognition, asset classification and provisioning (IRACP) norms; concentration and other exposure norms; and deposit acceptance would be undertaken in a phased manner over next two years to ensure that the transition is achieved with least disruption.

VI.44 Master Directions for HFCs covering all applicable regulations were issued on February 17, 2021.

Comprehensive Review of CIC Guidelines

VI.45 Based on the recommendations of the Working Group (WG) to review the Regulatory and Supervisory Framework for CICs (Chairman: Shri Tapan Ray) and inputs received from stakeholders, the revised guidelines for CICs were issued on August 13, 2020. The highlights of the major changes are as under:

- Adjusted net-worth to deduct amount representing any direct or indirect capital contribution made by one CIC into another CIC beyond a threshold of 10 per cent of own funds of investing in CIC.
- The number of layers of CICs within a group (including the parent CIC) shall be restricted to two, irrespective of the extent of direct or indirect holding/control exercised by a CIC.
- The parent CIC in the group or the CIC with the largest asset size, in case there is no identifiable parent CIC in the group, shall constitute a Group Risk Management Committee (GRMC).
- CICs with asset size of more than ₹5,000 crore, shall appoint a Chief Risk Officer (CRO).
- CICs shall prepare consolidated financial statements (CFS) as per provisions of the Companies Act, 2013. Suitable disclosures have been prescribed for the group entities, whose accounts are not eligible for such consolidation, among others.

Major Developments

Extension of Timeline for Finalisation of Audited Accounts

VI.46 In view of the operational difficulties posed by the ongoing pandemic situation, it was decided that every NBFC shall finalise its balance sheet

within a period of three months from the date to which it pertains or any date as notified by Securities and Exchange Board of India (SEBI) for submission of financial results by the listed entities. A circular in this regard was issued on July 6, 2020.

Draft Guidelines on Declaration of Dividend by NBFCs

VI.47 Unlike banks, currently there are no guidelines in place with regard to distribution of dividend by NBFCs. Keeping in view the increasing significance of NBFCs in the financial system and their inter-linkages with other segments of the financial system, it has been decided to formulate guidelines on dividend distribution by NBFCs. Different categories of NBFCs would be allowed to declare dividend as per a matrix of parameters, subject to certain conditions. A draft circular in this regard was placed in the public domain on December 9, 2020, soliciting comments from stakeholders.

Notification of Alternative Investment Funds (AIFs) as Qualified Buyers

VI.48 To ensure uniform treatment for all AIFs, category I AIFs set up as trusts and registered with SEBI under SEBI (AIF) Regulations, 2012, have been notified as qualified buyers under section 2(1)(u) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

Agenda for 2021-22

VI.49 During 2021-22, the Department will pursue the following goals in respect of NBFCs/ asset reconstruction companies (ARCs):

- Finalise Scale-based Regulatory Framework for NBFCs given the increasing significance of NBFCs in the financial system;

- Review of regulatory framework applicable to NBFC-MFIs and harmonising the regulatory frameworks for various regulated lenders in the microfinance space; and
- Comprehensive review of the regulatory and legal framework of ARCs so as to realise their potential in resolving stressed assets of the financial sector.

4. SUPERVISION OF FINANCIAL INTERMEDIARIES

Department of Supervision (DoS)

Commercial Banks

VI.50 The Department of Supervision (DoS) is entrusted with the responsibility of supervising all SCBs (excluding RRBs), Local Area Banks (LABs), PBs, SFBs, Credit Information Companies and all India financial institutions (AIFIs).

Agenda for 2020-21: Implementation Status

Goals Set for 2020-21

VI.51 The Department had set out the following goals for supervision of SCBs during 2020-21:

- A detailed prescriptive framework will be introduced, covering the roles and authority of the Chief Compliance Officer (CCO) of a bank, to bring uniformity in approach besides aligning the expectations on CCO with best practices (*Utkarsh*) [Para VI.52];
- Assessment of risk and compliance culture and business strategy of SCBs to strengthen the health of the financial system, with special attention to the unique risks posed by climate change and implications for the supervisory framework (*Utkarsh*) [Para VI.53 - VI.54]; and

- The Department will further strengthen the process of collecting supervisory data relating to KYC/anti money laundering (AML) which would facilitate better risk discovery, risk assessment and risk-based supervision (RBS) processes in respect of KYC/AML supervision, and the preparation of a model to risk profile the banks for carrying out risk-based KYC/AML inspection (Para VI.55).

Implementation Status of Goals

Compliance Function in Banks

VI.52 To bring uniformity in the compliance function/structure of banks as also to align the supervisory expectations on role of CCO with best practices, the guidelines on compliance function in banks have been amended *vide* circular dated September 11, 2020. The guidelines are aimed at enhancing the independence, authority, transparency and responsibility of the CCOs; and further provide that the CCO should meet the 'fit & proper' criteria and that the stature of the CCO should be such that the CCO has the ability to independently exercise judgement and ensure that business functions comply with relevant laws/regulations/policies.

Risk and Compliance Culture Assessment Framework

VI.53 Recognising the significance of sound risk and compliance culture in building a robust internal control framework and for enhancing overall effectiveness of the bank's operations, the Department has developed a detailed risk and compliance culture assessment framework for the guidance of senior supervisory managers (SSMs). The objective of this framework is to assist supervisors in identifying practices, behaviours

and attitudes that may adversely influence the institution's risk culture.

Minimum Supervisory Expectations (MSEs)

VI.54 The Department has also prepared a guidance note for SSMs containing MSEs comprising best practices and standards on risk governance, compliance and internal audit which the banks are required to follow as a supervisory floor. The SSMs are using these MSEs as a benchmark to assess the adequacy of assurance functions in the banks as also to strengthen the assessment of assurance functions in terms of their robustness, efficacy and adequacy.

Risk-Based Approach (RBA) for KYC/AML

VI.55 As part of their internal governance structure, banks are required to have a sound risk-management strategy for addressing the KYC/AML risks. The Reserve Bank, on the lines of recommendations of Financial Action Task Force (FATF), has developed RBA for supervision from KYC/AML perspective. A model for generation of risk scores, based on the KYC/AML data submitted by the banks, has also been developed. A specialised on-site assessment is also being carried out for select banks based on their KYC/AML risk scores/rating. RBA will facilitate better risk-discovery and improved risk-assessment besides effectively addressing and mitigating the money-laundering and terrorist financing risks in the banking sector.

Major Developments

Root Cause Analysis (RCA)

VI.56 A special thrust is given from the current supervisory cycle towards carrying out RCA which, *inter alia*, includes a detailed assessment of governance, oversight and assurance function, business strategy and risk and compliance culture.

Supervision of Internationally Active Indian Banks through Supervisory Colleges

VI.57 The platform of supervisory colleges is being utilised to monitor internationally active Indian banks on an ongoing basis. Due to COVID-19 pandemic induced restrictions, supervisory college meetings were conducted in virtual mode during which overseas supervisors of these banks actively participated in deliberations.

Automation of Income Recognition, Asset Classification and Provisioning (IRACP) Processes in Banks

VI.58 Banks were advised, *vide* circular dated September 14, 2020, to automate their IRACP processes. In order to ensure the completeness and integrity of the automated asset classification [classification of advances/investments as non-performing asset (NPA)/non-performing investment (NPI) and their upgradation], provisioning calculation and income recognition processes, banks have been advised to put in place/upgrade their systems to conform to the prescribed guidelines latest by June 30, 2021.

Long Form Audit Report (LFAR) – Review

VI.59 Keeping in view the large-scale changes in the size, complexities, business model and risks in the banking operations, a review of the LFAR format, in consultation with the stakeholders, including the Institute of Chartered Accountants of India (ICAI), was undertaken and the format of LFAR was revised. The revised guidelines issued on September 5, 2020, *inter alia*, require the statutory auditors (SAs) to also report on special prudential supervisory requirements besides reporting on the financial statements.

Cyber Security Related Developments

VI.60 Appreciating that the environment of cyber security and technology risks facing

banks is constantly evolving, the Department has instituted a system of periodic interactions with Chief Information Security Officers (CISOs) of banks. The objective of such meetings is to engage with stakeholders on the ground to get a sense of the challenges in a post-pandemic world characterised by shift in users' interface with information technology (IT) systems, the best practices employed by banks and new threats envisaged due to adoption of new technological and operating paradigms such as cloud computing and open banking. This new system is seen as one of the ways in which the dynamics of supervision are changing to a more adaptive approach to building a cyber-resilient banking system.

Frauds Analysis

VI.61 The number of frauds reported during 2020-21 decreased by 15 per cent in terms of number and 25 per cent in terms of value, *vis-à-vis* 2019-20 (Table VI.2). The share of PSBs in total frauds (both in terms of number and value) decreased while that of private sector banks increased during the corresponding period.

VI.62 In terms of area of operations, frauds have been occurring predominantly in the loan portfolio (advances category), both in terms of number and value (Table VI.3). Though the value of frauds reported in advances category for 2020-21, in percentage terms, remained almost same as compared to the last year, the incidence of frauds in advances category, in terms of number, has come down over the previous year. The share of off-balance sheet (in terms of value) has been decreasing since 2018-19.

VI.63 The average time lag between the date of occurrence of frauds and the date of detection was 23 months for the frauds reported in 2020-21.

Table VI.2: Fraud Cases - Bank Group-wise

(Amount in ₹ crore)

Bank Group/Institution	2018-19		2019-20		2020-21	
	Number of Frauds	Amount Involved	Number of Frauds	Amount Involved	Number of Frauds	Amount Involved
1	2	3	4	5	6	7
Public Sector Banks	3,704 (54.5)	64,207 (89.8)	4,410 (50.7)	1,48,224 (79.9)	2,903 (39.4)	81,901 (59.2)
Private Sector Banks	2,149 (31.6)	5,809 (8.1)	3,065 (35.2)	34,211 (18.4)	3,710 (50.4)	46,335 (33.5)
Foreign Banks	762 (11.2)	955 (1.3)	1026 (11.8)	972 (0.5)	521 (7.1)	3,315 (2.4)
Financial Institutions	28 (0.4)	553 (0.8)	15 (0.2)	2,048 (1.1)	25 (0.3)	6,839 (4.9)
Small Finance Banks	115 (1.7)	8 (0.0)	147 (1.7)	11 (0.0)	114 (1.6)	30 (0.0)
Payments Banks	39 (0.6)	2 (0.0)	38 (0.4)	2 (0.0)	88 (1.2)	2 (0.0)
Local Area Banks	1 (0.0)	0.02 (0.0)	2 (0.0)	0.43 (0.0)	2 (0.0)	0 (0.0)
Total	6,798 (100.0)	71,534 (100.0)	8,703 (100.0)	1,85,468 (100.0)	7,363 (100.0)	138,422 (100.0)

Note: 1. Figures in parentheses represent shares in total (in per cent).

2. Figures reported by banks & FIs are subject to change based on revisions filed by them.

3. Amounts involved reported do not reflect the amount of loss incurred. Depending on recoveries, the loss incurred gets reduced. Further, the entire amount involved is not necessarily diverted.

4. The dates of occurrence of these frauds are spread over several previous years.

5. The above data is in respect of frauds of ₹1 lakh and above reported during the period.

Source: RBI Supervisory Returns.

However, in respect of large frauds of ₹100 crore and above, the average lag was 57 months for the same period.

Agenda for 2021-22

VI.64 The Department has identified the following goals for supervision of SCBs in 2021-22:

- Strengthening the on-site assessment of oversight and assurance functions including risk and compliance culture as also business strategy/model (*Utkarsh*);
- Adoption of innovative and scalable SupTech to enhance the efficiency and efficacy of supervisory processes by modifying its capacity and capability (*Utkarsh*);

- Streamlining the process of data collection from all the banks and their off-site assessment and on-site supervision of select banks based on the outcome of risk-based model developed for KYC/AML supervision; and
- Enhancement of Fraud Risk Management System including improving efficacy of Early Warning Signal (EWS) framework, strengthening fraud governance and response system, augmenting the data analysis for monitoring of transactions, introduction of dedicated market intelligence (MI) unit for frauds and implementation of automated unique system generated number for each fraud.

Table VI.3: Fraud Cases – Area of Operations

(Amount in ₹ crore)

Area of Operation	2018-19		2019-20		2020-21	
	Number of Frauds	Amount Involved	Number of Frauds	Amount Involved	Number of Frauds	Amount Involved
1	2	3	4	5	6	7
Advances	3,603 (53.0)	64,539 (90.2)	4,608 (52.9)	1,81,942 (98.1)	3,501 (47.5)	1,37,023 (99.0)
Off-balance Sheet	33 (0.5)	5538 (7.7)	34 (0.4)	2445 (1.3)	23 (0.3)	535 (0.4)
Foreign Exchange Transactions	13 (0.2)	695 (1.0)	8 (0.1)	54 (0.0)	4 (0.1)	129 (0.1)
Card/Internet	1,866 (27.5)	71 (0.1)	2,677 (30.8)	129 (0.1)	2,545 (34.6)	119 (0.1)
Deposits	593 (8.7)	148 (0.2)	530 (6.1)	616 (0.3)	504 (6.8)	434 (0.3)
Inter-Branch Accounts	3 (0.0)	0 (0.0)	2 (0.0)	0 (0.0)	2 (0.0)	0 (0.0)
Cash	274 (4.0)	56 (0.1)	371 (4.3)	63 (0.0)	329 (4.5)	39 (0.0)
Cheques/Demand Drafts, etc.	189 (2.8)	34 (0.1)	201 (2.3)	39 (0.0)	163 (2.2)	85 (0.1)
Clearing Accounts, etc.	24 (0.4)	209 (0.3)	22 (0.2)	7 (0.0)	14 (0.2)	4 (0.0)
Others	200 (2.9)	244 (0.3)	250 (2.9)	173 (0.1)	278 (3.8)	54 (0.0)
Total	6,798 (100.0)	71,534 (100.0)	8,703 (100.0)	1,85,468 (100.0)	7,363 (100.0)	1,38,422 (100.0)

Note: 1. Figures in parentheses represent the percentage share of the total.

2. Figures reported by banks & FIs are subject to change based on revisions filed by them.

3. The above data is in respect of frauds of ₹1 lakh and above reported during the period.

4. The dates of occurrence of these frauds are spread over several previous years.

5. Amounts involved reported do not reflect the amount of loss incurred. Depending on recoveries, the loss incurred gets reduced. Further, the entire amount involved in advances is not necessarily diverted.

Source: RBI Supervisory Returns.

Urban Cooperative Banks (UCBs)

VI.65 The Department also undertook periodic monitoring of the UCBs during the year to ensure the development of a safe and well-managed cooperative banking sector.

Agenda for 2020-21: Implementation Status

Goals Set for 2020-21

VI.66 The Department had set out the following goals for supervision of UCBs in 2020-21:

- Introduction of differentiated supervision mechanism for select UCBs (*Utkarsh*) [Para VI.67];

- Integration of core banking solution (CBS) modules of UCBs for all core functions; modules to be automated for effective supervision (*Utkarsh*) [Para VI.68];
- Utilising Centralised Repository of Information on Large Credits (CRILC) reporting for the UCB sector for enhanced supervisory examination (*Utkarsh*) [Para VI.69]; and
- Adapting the inspection process of UCBs to the changing needs of the sector focusing on size and periodicity (Para VI. 67 - VI.69).

Implementation Status of Goals*Differentiated Supervision Mechanism for UCBs*

VI.67 For UCBs, a calibrated supervisory approach has been adopted. The objectives are to strengthen the oversight on material institutions in these segments in a more risk-focused manner, improve proportionality and economic efficiency of supervision, and to deploy an appropriate range of tools and technology to achieve the supervisory objectives (Box VI.3).

Making UCBs - CBS Compliant

VI.68 1,531 out of 1,536 UCBs (99.67 per cent) have implemented CBS as on March 31, 2021. Three out of remaining five UCBs are under AID

(negative net worth). Only 2 UCBs with positive net worth are yet to complete CBS implementation.

CRILC Reporting for UCBs

VI.69 UCBs with assets of ₹500 crore and above have been brought under CRILC reporting framework with the objective of strengthening off-site supervision and early recognition of financial distress. It has enabled more holistic view of large borrowers of the select large UCBs. Data from CRILC returns has been used for identification of supervisory concerns, viz., delinquent borrowers and exposures of banks to sensitive sectors. This will also enable the Department to prepare appropriate analytical reports pertaining to UCB sector. Apart from review and analysis of CRILC

Box VI.3**Changing Paradigm of UCB Supervision – Way Forward**

UCBs play a key role in furthering the financial inclusion agenda of the Reserve Bank and have obvious advantages in terms of servicing people of small means in semi-urban and urban areas. The UCB sector is unique in the sense that there is a significant degree of heterogeneity among banks in this sector in terms of size, geographical distribution, performance and financial soundness. The sector has unit UCBs, multi-branch UCBs operating within a state and multi-state UCBs with the area of operation in more than one state.

Cooperative banks with their better knowledge of customers and familiarity with the area of operation can attract new customers and retain the existing clientele with their unique selling proposition. This may require suitable changes in outlook, processes, business model and strategy.

However, cooperative banks are now functioning in a highly competitive environment. Entry of more players in the banking arena and technology have increased options to customers and banks have both opportunities to grow and challenges for survival. As banking business becomes more complex and competitive, the need for skilled workforce will increase, regular investments in IT infrastructure would be required and the cost of compliance would also go up.

The Reserve Bank has taken several measures to enhance supervision of UCB sector under the new unified

Department of Supervision (DoS) such as implementation of core banking solution (CBS) in UCBs, revised CAMELS (Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and Systems and Control) rating model for UCBs, detailed data analytics and assessment of vulnerabilities, assessment of cyber risk, centralisation of off-site/eXtensible business reporting language (XBRL) reporting mechanism and meetings/interactive sessions with chief executive officers (CEOs)/directors of weak/vulnerable UCBs.

The Reserve Bank has announced in the Statement on Developmental and Regulatory Policies of February 5, 2021, about setting up of an expert committee on UCBs involving all stakeholders in order to provide a medium-term roadmap to strengthen the sector, enable faster rehabilitation/resolution of UCBs, as well as to examine other critical aspects relating to these entities. The committee will suggest effective measures for faster rehabilitation/resolution of UCBs, assess potential for consolidation in the sector, consider the need for differential regulations and examine prospects to allow more leeway in permissible activities for UCBs with a view to enhance their resilience and draw up a vision document for a vibrant and resilient urban cooperative banking sector having regards to the principles of cooperation as well as depositors' interest and systemic issues.

Source: RBI.

data, interactive dashboards have been developed and are shared with supervisory teams to help in identifying banks exhibiting signs of incipient stress.

Other Initiative

VI.70 The cyber security landscape continues to evolve with wider adoption of digital banking channels, thus necessitating UCBs to manage their associated risks effectively. Active collaboration within UCBs and their stakeholders was felt necessary for sharing and coordinating various measures taken on cyber security aspects. To this effect, a “Technology Vision Document for Cyber Security” for UCBs was published which envisages to achieve this objective over a period of three years through a five-pillared strategic approach ‘GUARD’ - Governance Oversight, Utile Technology Investment, Appropriate Regulation and Supervision, Robust Collaboration, and Developing Necessary IT & Cyber Security Skillset.

Agenda for 2021-22

VI.71 The Department has identified the following goals for supervision of UCBs in 2021-22:

- Conduct IT/cyber security examination of scheduled UCBs (*Utkarsh*);
- Developing the risk-based approach for KYC/AML supervision of select UCBs;
- Strengthening Early Warning System and stress testing framework for UCBs; and
- Roll out of IT Examination for select UCBs.

Non-Banking Financial Companies (NBFCs)

VI.72 The Department continued to effectively monitor the NBFCs (excluding HFCs) and ARCs registered with the Reserve Bank with the objective to protect the interests of depositors and customers, while ensuring financial stability.

Agenda for 2020-21: Implementation Status

Goals Set for 2020-21

VI.73 The Department had set out the following goals for supervision of NBFCs for 2020-21 under *Utkarsh*:

- Steps will be taken to improve effectiveness of the supervision and monitoring of NBFCs by (i) ascertaining the quality of implementation of Indian Accounting Standards (Ind-AS) and subsequent regulatory guidance/directions; (ii) strengthening MI on NBFCs to assess the movement of financial parameters/market outlook of NBFCs and related parties on an ongoing basis; (iii) promoting a strong compliance and risk culture amongst NBFCs, and (iv) weeding out NBFCs not compliant with the Reserve Bank’s directions with respect to maintenance of adequate net owned funds (NOF) and returns filing (Para VI.74 - VI.79).

Implementation Status of Goals

Implementation of Ind-AS

VI.74 Regulatory guidance on implementation of Ind-AS was issued on March 13, 2020 which covered governance framework for Ind-AS implementation, prudential floors for expected credit loss along with guidance on computation of regulatory capital and regulatory ratios. Supervision of NBFCs also covered the quality of implementation of Ind-AS during the current supervisory cycle.

Supervision of NBFCs

VI.75 As part of the strengthened off-site surveillance mechanism for NBFCs, the structural liquidity position of deposit taking NBFCs (NBFC-D) and non-deposit taking systemically

important NBFCs (NBFC-ND-SI) and CICs is being assessed every month to identify those NBFCs/CICs which present significant negative mismatch in any time bucket over subsequent six months period. Quarterly analytical reports on financial performance of NBFC sector are prepared indicating trends in asset growth, capital adequacy, asset quality, profitability, sectoral credit and liquidity.

VI.76 The early warning framework for banks and NBFCs has recently been introduced as part of the proactive off-site surveillance framework. This framework involved the identification of statistically significant variables that may provide early warning signs for banks/NBFCs and also a pool of indicators to cover macroeconomic variables, market indicators, and banking indicators.

VI.77 As part of the 5th pillar of supervision, the Department is having sustained engagement with the senior management of NBFCs, particularly the larger companies. Any sign of stress, excessive growth in assets, sudden increase in delinquency or liquidity mismatch and/or deterioration in the

financials is taken up with the management of SEs.

VI.78 For ensuring firm implementation of regulations, enhanced interaction with the NBFCs, both at central office (CO) and regional office (RO) levels, is being conducted. This becomes all the more important in the light of structural changes in the business models of NBFCs that require a dynamic supervisory focus (Box VI.4).

VI.79 The Department has been identifying the NBFCs that do not comply with the minimum net owned funds (NOF) requirements and has been cancelling the certificate of registration (CoR) of such NBFCs.

Agenda for 2021-22

VI.80 The Department has identified the following goals for supervision of NBFCs in 2021-22:

- Designing supervisory reporting system under Ind-AS (*Utkarsh*);
- Implementation of central fraud registry (CFR) for NBFCs (*Utkarsh*);
- Strengthening MI and off-site supervisory assessment of NBFCs;

Box VI.4

Structural Changes in Business Models of Non-Banking Financial Companies (NBFCs) and Strengthened Supervision

NBFCs play a critical role in financial intermediation and promoting inclusive growth by providing last-mile access of financial services to meet the diversified financial needs of less-banked customers.

Globally, the sector is witnessing some transformative trends, such as rapid expansion in collective investment vehicles in the sector, increase in cross-border linkages of such entities, increased dependence on short-term funding and increased recourse to financial innovation such as peer-to-peer lending, crowdfunding, leveraged loans and

collateralised loan obligations (CLOs), besides increased reliance on FinTech and digital technologies. Thus, the business models of NBFCs are changing world over.

In India, recent credit or market events at certain large NBFCs followed by liquidity strains and the related financial stability concerns have resulted in changes in the business model as well as enhancement in the supervisory focus for NBFCs. It would be contextual to take stock of the direction in which supervisory focus has moved and the changing landscape of the NBFC sector.

(Contd.)

Strengthening supervision over NBFCs: In the aftermath of liquidity stress post the Infrastructure Leasing & Financial Services (IL&FS) and Dewan Housing Finance Ltd. (DHFL) events, the market funding conditions turned difficult for NBFCs. While NBFCs with better governance standards, robust business models and efficient operating practices did well and could raise funds, others bore the brunt of the market forces. Smaller NBFCs and microfinance institutions (MFIs), which were contributing significantly to the last mile credit delivery, also got impacted as their funding sources got further squeezed.

In response, the Reserve Bank took several calibrated steps to channel credit flow into the NBFC sector and enhanced supervision to improve the sector's long-term resilience. Some of the specific measures initiated by the Reserve Bank to strengthen the supervision of NBFCs include - conducting scale-based supervision (including introduction of senior supervisory manager approach), inspection of government owned NBFCs and core investment companies (CICs); revision and rationalisation of returns and migration from computerised off-site monitoring and surveillance system (COSMOS) platform to more advanced eXtensible business reporting language (XBRL) platform; ensuring online submission of annual certificate by statutory auditors (SAs) of NBFCs on XBRL platform; introducing 11 regional languages on the *sachet* portal for information on *ponzi* schemes/unauthorised deposit collection and actively pursuing the fifth pillar of supervision - engagement with stakeholders.

Structural Changes in Business Models of NBFCs: NBFCs have come a long way in terms of their scale and diversity of operations. Over the years, the segment has grown rapidly with a few of the large NBFCs becoming comparable in size to some of the private sector banks. The sector has also seen advent of many non-traditional players leveraging technology to adopt tech-based innovative business models.

Liquidity problems, increased asset quality stress and COVID-19 fallout along with availability of innovative technology has induced NBFCs to reimagine their business models. During recent years, there has been a structural shift on the asset and liability side of NBFCs' balance sheets. As the Reserve Bank required NBFCs to adopt a liquidity risk management framework from December 2020, NBFCs have been gradually swapping their short-term liabilities with long-term borrowings with the aim of maintaining adequate liquidity. Similarly, there has been increasing shift towards

retail loans and loans to service sector as well as micro, small and medium enterprises (MSMEs), from the earlier focus on corporate sector advances.

Financial technology (FinTech) based product delivery is another important development taking place in the NBFC landscape. The NBFC sector has been in the forefront of adopting innovative FinTech-led delivery of products and services which are transforming the way one can access and interact with these services. The scope of operations of FinTechs has also broadened, moving to payments, insurance, stocks, bonds, peer to peer lending, robo-advisers, regulatory technology (RegTech) and supervisory technology (SupTech). However, concerns relating to data confidentiality, robustness of information technology (IT) infrastructure and cyber security framework, as also conduct of business issues need to be evaluated and addressed.

Factoring Regulation (Amendment) Bill, 2020, *inter alia*, seeks to amend section 3 to widen the scope of financiers and to permit all NBFCs to undertake factoring business and participate on the trade receivables discounting system platform for discounting the invoices of MSMEs. The bill is expected to open up additional business opportunities for NBFCs and may realign the share of factoring business between banks and NBFCs with more number of NBFCs joining the fray. Going forward, a marketplace driven platform model has the potential to redefine the NBFCs by leveraging their strengths - customer base, distribution reach and collaboration with varied ecosystems. As a take-off point from being an underwriter for various types of loans, NBFCs can bank upon their strengths and move towards alternate business models hinged upon distribution.

In a nutshell, the NBFC segment has entered into a new business landscape wherein it needs to continuously strive to innovate and add new products to its toolkit. Core strength of NBFCs include customer base; strong distribution and servicing reach; higher risk appetite; flexible business model; non-physical points of presence; and faster scale-up and scale-down capability. The NBFCs have also been fast in adopting newer technology led processes. Leveraging the above, product providers like NBFCs can consider expanding into marketplace driven platforms to serve a customer with multitude of products and services while ensuring customer protection. The Reserve Bank is carefully observing the changing trajectory of their business operations and associated risks and taking appropriate measures to sustain their resilience.

Source: RBI.

- Developing the risk-based approach for KYC/AML supervision of select NBFCs;
- Monitoring effectiveness of customer services provided by NBFCs; and
- Roll out of IT Examination for select NBFCs.

Supervisory Measures for All Supervised Entities (SEs)

VI.81 A unified DoS has been operationalised in which the supervision of banks, UCBs and NBFCs are now being undertaken in a holistic manner under one umbrella Department. This will address inter-institutional issues on regulatory/supervisory arbitrage, information asymmetry and interconnectedness.

Agenda for 2020-21: Implementation Status

Goals Set for 2020-21

VI.82 The Department had set out the following supervisory goals for 2020-21:

- Under the aegis of the standing committee on cyber security, a pro-active cyber immunity surveillance framework will be introduced for SEs to automate data flow from the SEs to the Reserve Bank for better analysis, cyber simulation/assessment exercises in collaboration with Reserve Bank Information Technology (ReBIT) and the industry, prompt supervisory/regulatory intervention, besides prescribing certain baseline requirements for various other critical service providers (CSPs), Master Directions on IT practices (governance and related) and digital banking security expectations for the banking sector (Para VI.83 - VI.85);
- A study on the large value frauds with the involvement of select banks, NBFCs, UCBs and domain experts will be undertaken for recognising the causes

for delay in identifying frauds by SEs and suggest measures for early detection and timely mitigation of the risks arising out of frauds (Para VI.86);

- Implementation of Integrated Compliance Management and Tracking System (ICMTS) [Para VI.86]; and
- The Reserve Bank is engaged in interlinking various databases and information systems to improve fraud monitoring and detection. Online reporting of frauds by NBFCs and the CFR portal of SCBs, augmented with new features, will be made operational by January 2021 (Para VI.86).

Implementation Status of Goals

Cyber Security Related Developments

VI.83 The Department has conducted IT examinations (on-site as well as off-site modes) in 53 SEs during July 2020 to March 2021. This includes 44 SCBs, four Primary UCBs, two PBs, one NBFC, one CIC and one financial institution (FI).

VI.84 The standing committee on cyber security has set up a sub-group to discuss the feasibility of setting up “Sectoral Security Operations Centre (SoC)” for the REs of the Reserve Bank, which would, among other things, seamlessly pull logs/events/alerts from the SoC of REs for further analysis. Web crawling/cyber recon exercises through external agencies was conducted on pilot basis with select REs. Currently, work on extending this to other REs is being undertaken.

VI.85 The Department collects risk indicator data from SEs through various returns, off-site submissions and compliance status. Based on the submissions of SEs, those that are found vulnerable or not compliant with extant instructions are advised to take necessary actions.

Strengthening Database and Information System

VI.86 Initiatives in this regard during 2020-21 were as follows:

- Keeping in view the delays observed in detection of large frauds by SEs, it was planned to undertake a study of large frauds with the involvement of a group comprising select banks, NBFCs, UCBs and experts to detect the causes and suggest measures to improve the systems. The group submitted its report on April 30, 2021.
- ICMTS is an end-to-end workflow automation application, envisaged to strengthen the compliance by the SEs and assist in the timely and continuous monitoring of compliance of the time bound circulars/instructions/advisories issued by various departments such as DoS and DoR. The application will also facilitate planning of inspection/scrutiny of SEs and subsequent compliance of observations with inbuilt facility to raise alerts for reminders and notifications. Phase-wise implementation of various modules of the application is in progress.
- The Department has proposed a unified fraud reporting format common to all commercial banks (including select FIs), UCBs and NBFCs, which will enable consolidation of reports pertaining to fraud data reported by all such reporting entities and facilitate interlinking of various databases and information systems. It is being developed and implemented as part of the ensuing centralised information management system (CIMS) project. Meanwhile, certain augmentations to optimise and accelerate search queries

have been carried out in the current CFR portal of SCBs, which have been implemented *w.e.f.* April 1, 2021.

- Online fraud reporting system for NBFCs has been developed and the deployment and on boarding of NBFCs to the online system will be effected after the completion of ongoing infrastructure related transition, security testing and the issue of relevant guidelines/notifications.
- Reserve Bank had mandated risk based internal audit (RBIA) for commercial banks in 2002. Considering the importance of internal audit function as a third line of defence and in a move to harmonise the guidelines across all SEs, large UCBs and NBFCs were brought within the RBIA net during the year.
- Further, in order to strengthen the audit systems in SEs and to ensure that SAs are appointed in a timely, transparent and effective manner by all SEs, the Department issued harmonised guidelines on appointment of statutory central auditors (SCAs)/SAs of commercial banks (excluding RRBs), UCBs and NBFCs (including HFCs). These guidelines provide necessary instructions regarding the number of auditors, their eligibility criteria, tenure and rotation, while ensuring the independence of auditors.

Major Developments

Dedicated Risk Specialist Division

VI.87 A dedicated horizontal risk function, *viz.*, Risk Specialist Division (RSD) was created in the process of unification of supervision function. The RSD has been working towards developing specialisation in major risk areas, both financial and non-financial, and contributing towards risk discovery.

Strengthening Risk-Based Supervision

VI.88 The supervisory framework for commercial banks, NBFCs and UCBs has been harmonised with the broad supervisory architecture of the unified Department. This has been done while keeping in view the size of these entities in matters related to financial stability as also other non-financial parameters. For this purpose, a calibrated supervisory approach has been adopted. The objectives are to improve proportionality and economic efficiency of supervision by optimal use of supervisory resources, strengthen the oversight on material institutions in a more risk-focused manner, and to deploy an appropriate range of tools and technology to achieve the supervisory objectives.

Off-site Supervision

VI.89 The Department took several initiatives to further strengthen identification of vulnerable SEs and ensure immediate follow-up on the identified vulnerabilities. This was guided by proactive off-site supervision mechanisms, viz., macro-stress tests; early warning mechanisms; and identification of vulnerable SEs through quarterly proactive off-site surveillance exercise for banks, NBFCs, SFBs and UCBs. The macro-stress testing exercise for banks follows a top-down approach and includes credit risk stress test (using three panel data econometric models linking the real and financial sectors), a reverse stress test to assess liquidity risk, a new stress test to analyse large exposures at the system level, and a new duration-based stress test for interest-rate risk (IRR) that incorporates stress to the loan book as well as the trading book. Stress testing analysis for NBFCs is based on single factor sensitivity analysis to assess the resilience of the sector to shocks in different types of risk. Resilience to shocks in credit risk, credit concentration risk, sectoral credit risk, liquidity

risk and market risk are assessed. Stress testing methodology adopted for UCBs is also based on single factor sensitivity analysis. This framework covers models for assessing resilience against shocks to credit risk, concentration risk, interest rate risk that incorporates stress to the loan book as well as the trading book, in addition to liquidity stress test based on LCR method.

VI.90 Quarterly proactive off-site vulnerability assessment exercises are carried out for banks, NBFCs, SFBs and UCBs using the tool kits like data analytics, early warning systems, identification of vulnerable borrowers, stress testing, vulnerability on cyber security parameters and through different thematic analysis.

VI.91 Several thematic studies were conducted during the year to provide inputs to the Top Management for proactive policy interventions in the areas of concern.

VI.92 The scope of MI has widened with the inclusion of banks, NBFCs and UCBs under unified supervisory structure and the work further expands with the inclusion of entities in unregulated space. A dedicated MI section has been constituted under the unified DoS, as a tool for effective off-site supervision. A system of informal/unstructured meetings with various stakeholders has been put in place to get useful information on SEs. The MI unit complements the quarterly assessment reports prepared for banks, SFBs, UCBs and NBFCs.

VI.93 A standing committee on analytics has been constituted to guide the Department regarding adoption of industry standards and best practices in the fields of data intelligence/business analytics and risk modelling so as to improve the quality of overall analytical inputs and to strengthen and scale up the predictive and prescriptive analytics.

Capacity Development and Skill Enhancement

VI.94 As part of the measures to further strengthen supervision over REs, the Reserve Bank had set up a CoS to augment and reinforce supervisory skills among its regulatory and supervisory staff both at entry level and on a continuous basis. This was done to facilitate the development of unified and focused supervision by providing training and other developmental inputs to the concerned staff. While the CoS was functioning in a limited way in virtual mode since May 2020, it has since been fully operationalised with a full-time Director supported by an Academic Advisory Council (AAC) since January 2021. The full-fledged operationalisation of the CoS in both virtual and physical mode will further enhance the quality of oversight of SEs by augmenting and ensuring a consistent pool of skilled resources.

Agenda for 2021-22

VI.95 The Department proposes to achieve the following goals for supervision of all SEs in 2021-22:

- Integrate supervisory data structure for the Reserve Bank's REs by reviewing and consolidating the present scattered framework of returns (*Utkarsh*);
- Strengthening cyber security monitoring mechanism for SEs (*Utkarsh*);
- Implementation of central fraud registry for NBFCs (*Utkarsh*);
- Issuing of guidelines on IT governance, risk, controls and assurance practices; and
- The CoS, under guidance of AAC, will plan and develop curricula of all programmes based on identified areas where skill building/up-skilling are required, benchmark the programmes with international standards/best practices and develop appropriate teaching methods.

Enforcement Department (EFD)

VI.96 The Enforcement Department (EFD) was set up in April 2017 to enforce regulations uniformly across banks, with the objective of engendering compliance by REs, within the overarching principles of ensuring financial stability, public interest and consumer protection. The enforcement policy and framework approved by the Board for Financial Supervision (BFS) emphasises the need to be objective, consistent and non-partisan in undertaking enforcement. Enforcement in respect of cooperative banks and NBFCs was also brought under the scope of operations of the Department with effect from October 3, 2018.

Agenda for 2020-21: Implementation Status

Goals Set for 2020-21

VI.97 The Department had set out the following goals for 2020-21:

- A formal feedback process for DoS on areas most prone to violations to facilitate effective compliance testing would be put in place (*Utkarsh*). For this purpose, based on the experience gained since its inception, the Department would carry out an analysis of the violations and their *modus operandi* (Para VI.98);
- The enforcement policy and process would be reviewed in the wake of reorganisation of regulatory and supervisory departments, including work processes at ROs to ensure consistency in enforcement action (*Utkarsh*) [Para VI.99]; and
- The enforcement work pertaining to imposition of monetary penalties on HFCs by the Reserve Bank, to the extent provided for under the National Housing Bank (NHB) Act, 1987, would be brought under EFD in a phased manner (Para VI.100).

Implementation Status of Goals

VI.98 During the year, post resumption of near normal office functioning, the Department carried out analysis of the areas that are most prone to violations and the *modus operandi*. The results of the analysis have been shared with the DoS. A formal arrangement for sharing of feedback has also been put in place to facilitate effective compliance testing.

VI.99 In pursuance of the objective to ensure consistency in enforcement action, the Department had online interaction with the ROs to review work processes and with a view to understand challenges and constraints faced by them in undertaking enforcement. Necessary clarifications/guidance on issues have been provided. Further, training sessions were also organised to impart greater clarity on the enforcement process so as to move to consistency in enforcement action.

VI.100 As regards HFCs, while enforcement actions were sought to be undertaken by applying the existing policy *mutatis mutandis*, framing of a specific policy was contemplated as an addendum thereto, once Reserve Bank's regulatory framework for such institutions was fully devised and brought into force. DoR has since reviewed the regulations and issued revised regulatory framework for HFCs on October 22, 2020 and thereafter on February 17, 2021 issued the Master Directions for HFCs. Based on the clarity that has emerged on the role of the Reserve Bank under the NHB Act, and as the existing enforcement policy already provided for the principles and matrices to be applied and processes to be adopted for undertaking enforcement action against HFCs, the need for an

addendum to the existing policy was not considered immediately necessary. The Department would be undertaking enforcement action against HFCs in accordance with the existing policy.

Other Initiative

VI.101 During July 2020-March 2021, the Department undertook enforcement action against 54 REs and imposed an aggregate penalty of ₹19.41 crore for non-compliance¹ with provisions/contravention of certain directions issued by the Reserve Bank from time to time through various circulars (Table VI.4).

Agenda for 2021-22

VI.102 During the year ahead, the Department proposes to achieve the following goals:

- Implementation of the EFD's business process application and database of enforcement actions (*Utkarsh*);
- Review of enforcement policy and standard operating procedures (SOPs); and examining undertaking of enforcement

**Table VI.4: Enforcement Actions
(July 2020-March 2021)**

Regulated Entity	No. of Penalties	Total Penalty (₹ crore)
1	2	3
Public Sector Banks	3	4.50
Private Sector Banks	2	4.72
Cooperative Banks	39	2.14
Foreign Banks	2	4.00
Payments Banks	1	1.00
Small Finance Banks	-	-
NBFCs	7	3.05
Total	54	19.41

--: Nil.

Source: RBI.

¹ Illustratively, some of them include marketing/distribution of mutual fund/insurance products by banks; exposure norms and IRAC norms; Reserve Bank of India (frauds classification and reporting by commercial banks and select FIs) Directions, 2016; NBFC-ND-SI and NBFC-D directions on fair practices code applicable to NBFCs; and Master Circular on Board of Directors-UCBs.

- action against credit information companies (non-bank and non-NBFC);
- Review of existing practices and (business) processes to identify bottlenecks affecting timeliness in enforcement action and improving coordination with DoS and DoR, for ensuring undertaking of enforcement action within the fixed timelines;
 - Increased interaction and trainings aimed at improving consistency in decisions across ROs and putting in place an arrangement for sharing of information across EFD, ROs as also with CO; and
 - Improving coordination with NABARD and putting in place a coordination mechanism with NHB to facilitate effectual undertaking of enforcement action against HFCs.

5. CONSUMER EDUCATION AND PROTECTION

Consumer Education and Protection Department (CEPD)

VI.103 The Consumer Education and Protection Department (CEPD) frames policy guidelines to ensure protection of the interest of customers of REs in line with global best practices; undertakes oversight of the functioning of the ombudsman schemes of the Reserve Bank; and creates public awareness on safe banking practices, extant regulations on customer service and protection, and avenues for redress of customer complaints.

Agenda for 2020-21: Implementation Status

Goals Set for 2020-21

VI.104 The Department had set out the following goals for 2020-21:

- Strengthening financial education and awareness for the public (*Utkarsh*) [Para VI.105];
- Implementing the Internal Ombudsman (IO) scheme for select NBFCs (*Utkarsh*) [Para VI.106];
- Examining, for implementation, the recommendations of the in-house committee on convergence of the ombudsman schemes, including the role of consumer education and protection (CEP) cells (*Utkarsh*) [Para VI.107];
- Using artificial intelligence (AI) to enhance the efficacy of the Complaint Management System (CMS) of the Reserve Bank (Para VI.108); and
- Instituting a disincentive cum incentive framework to encourage banks to improve their grievance redress mechanism (Para VI.109).

Implementation Status of Goals

Strengthening Financial Education and Awareness for the Public

VI.105 CEPD undertook intensive awareness through a series of multi-media campaigns on the ombudsman schemes of the Reserve Bank, safe digital banking (covering threats like phishing/vishing, dubious links/emails/QR codes and SMS spoofing) and regulations on limited liability of customers in fraudulent digital transactions in coordination with Department of Communication (DoC). Additionally, a series of messages were displayed through tickers/scrolls on the Reserve Bank's website and the CMS webpage on safe digital banking during the lockdown. The banking ombudsmen conducted 154 awareness programmes among the members of public during the year, mostly through the digital mode on account of pandemic related restrictions. Of these, 34 awareness programmes were conducted in educational institutions. Further, a framework for education from the perspective of consumer

Box VI.5**Framework for Education from a Consumer Protection Perspective**

A framework for financial education with a specific focus on consumer protection has been developed, based on the guidance of the G-20 high level principles (HLP) on financial consumer protection (Principle 5: Financial Education and Awareness)²; the Organisation for Economic Cooperation and Development-International Network on Financial Education (OECD-INFE) HLP on national strategies for financial education; and the OECD-INFE guidelines on financial education in schools.

The framework lays down a strategy to empower consumers of regulated entities (REs), covering the following aspects, viz., (i) target groups classified on the

basis of their vulnerability and deficiency of information; (ii) content for financial education on consumer protection aligned to the needs of the target groups; (iii) multi-pronged delivery channels with maximum outreach to the intended people; (iv) coordination with various entities/departments/stakeholders to facilitate financial awareness from the consumer protection perspective; and (vi) a multi-mode mapping of the impact of the initiatives for estimating their effectiveness, identifying areas for improvement and determining the extent to which the framework achieved its objectives.

Source: RBI.

protection was developed to extend awareness on consumer protection issues among various target groups (Box VI.5).

Implementing the IO Scheme for Select NBFCs

VI.106 The IO, at the apex of the internal grievance redress mechanism of an entity, independently reviews the resolution provided by the entity in the case of wholly or partially rejected complaints. The IO scheme is already in operation in the case of banks (2018) and non-bank system participants (2019). The proposal to extend the IO scheme to all NBFCs covered under the Ombudsman Scheme for NBFCs (OSNBFC), 2018, was examined and it was concluded that considering the diversity in the size and business profile of NBFCs and the number of complaints received by NBFCs, the IO scheme may be extended to NBFCs based on identified thresholds. The proposed IO scheme for NBFCs will improve the internal grievance redress mechanism of the NBFCs covered.

Examining, for Implementation, the Recommendations of the In-house Committee on Convergence of the Ombudsman Schemes, including the Role of CEP Cells

VI.107 The Banking Ombudsman Scheme (BOS), launched in 1995, has served as a flagship alternate grievance redress mechanism for the redress of customer complaints against banks received by the Reserve Bank. Subsequently, the ombudsman scheme for NBFCs and the ombudsman scheme for digital transactions were launched in 2018 and 2019, respectively. The three ombudsman schemes are administered by CEPD. The in-house committee, set up to review the ombudsman framework and suggest measures to improve its efficacy, submitted its report in May 2020. The committee made wide-ranging recommendations, which included: (i) convergence of the three ombudsman schemes into an integrated "Reserve Bank of India Ombudsman Scheme"; (ii) expanding the ambit of this scheme to all REs presently not covered under the existing schemes to provide a

² Principle 5 states, *inter alia*, that financial education and awareness should be promoted by all relevant stakeholders and clear information on consumer protection, rights and responsibilities should be easily accessible by consumers.

single window for grievance redress; (iii) covering all complaints except those in the 'negative list'; (iv) subsuming CEP Cells within the ombudsman framework; (v) setting up a Centralised Receipt and Processing Centre (CRPC) for receipt and initial processing of complaints under the 'One Nation - One Jurisdiction' approach; (vi) reducing the turnaround time (TAT) for the redress of complaints; and (vii) introducing delegation by appointing a deputy ombudsman. The following major recommendations have been accepted for implementation:

- a. Convergence of the three ombudsman schemes (Banking Ombudsman Scheme, 2006; Ombudsman Scheme for NBFCs, 2018 and Ombudsman Scheme for Digital Transactions, 2019) into an integrated ombudsman scheme;
- b. Setting up a Centralised Receipt and Processing Centre (CRPC) and moving towards a 'One Nation – One Ombudsman' approach;
- c. Inclusion of REs not presently covered under the ombudsman schemes in a phased manner;
- d. Doing away with the grounds of complaints, including a definition of 'deficiency in customer service' and incorporating a detailed 'negative' or 'exclusions' list for rejection of a complaint;
- e. Delegation of power for the closure of complaints; and
- f. Updating CMS for incorporating the recommendations accepted for implementation.

Using AI to Enhance the Efficacy of CMS of the Reserve Bank

VI.108 Work on implementing AI in CMS was initiated during the year to effectively address the

quantitative and qualitative aspects of Reserve Bank's grievance redress mechanism and improve the efficiency of CMS. To start with, AI will equip CMS to filter out certain non-maintainable complaints at the time of lodgement. Going forward, AI will also serve as a decision support tool, apart from helping to refine data analytics and root cause analysis (RCA) of the complaints.

Instituting a Disincentive cum Incentive Framework to Encourage Banks to Improve their Grievance Redress Mechanism

VI.109 With a view to strengthen and improve the efficacy of the internal grievance redress mechanism of banks, and to provide better customer service, a comprehensive framework has been put in place comprising certain measures. The measures include, *inter alia*, enhanced disclosures on customer complaints by the banks and the Reserve Bank; recovering the cost of complaints' redress from banks when maintainable complaints are higher than their peer-group averages; intensive review of grievance redress mechanism; and supervisory/regulatory actions against banks that fail to improve their redress mechanism in a time bound manner.

Major Developments

Grievance Redress during the Pandemic

VI.110 The functioning of the ombudsman and CEP Cells continued uninterrupted and efficiently, even during the pandemic induced lockdown by leveraging the 24X7 availability of CMS and the end-to-end digitisation of the grievance redress mechanism.

Undertaking RCA of the Major Areas of Complaints

VI.111 The RCA of the major areas of complaints was conducted by the ombudsmen offices, CEP Cells and banks for the period ended June 2020 and the findings were consolidated and analysed.

Follow-up actions included advising banks to, (a) improve safety of the digital transactions through transaction pattern analysis and effective velocity checks; (b) ensure suitability in the issue of credit cards and independently assess the credit risk involved, especially in the case of students and those without independent financial means; (c) enhance customer protection through effective implementation of KYC norms as specified in the extant instructions; (d) implement regulations related to senior citizens and differently abled customers, as also limiting the liability of customers in unauthorised electronic banking transactions; and; (e) strengthen awareness efforts.

Agenda for 2021-22

VI.112 The Department proposes the following agenda under *Utkarsh* for 2021-22:

- Formulation of a policy/scheme for handling complaints not covered under the ombudsman schemes;
- Efforts for inclusion of safe banking practices in educational curriculum; and
- Extension of the IO scheme to NBFCs, financially sound and well managed UCBs and RRBs.

Deposit Insurance and Credit Guarantee Corporation (DICGC)

VI.113 Deposit insurance plays an important role in maintaining the stability of the financial system by assuring the protection of small depositors thereby ensuring public confidence in the financial system. The Deposit Insurance and Credit Guarantee Corporation (DICGC) is a wholly owned subsidiary of the Reserve Bank of India (RBI) constituted under the DICGC Act, 1961. Deposit insurance provided by the DICGC covers all insured commercial banks, including LABs, PBs, SFBs, RRBs and co-operative banks.

VI.114 The number of registered insured banks stood at 2,058 as on March 31, 2021, comprising 139 commercial banks (including 43 RRBs, 2 LABs, 6 PBs and 10 SFBs) and 1,919 co-operative banks (34 StCBs, 347 DCCBs and 1,538 UCBs). With deposit insurance in India covering all deposits up to ₹5 lakh, the number of fully protected accounts (247.8 crore) at end-March 2021 constituted 98.1 per cent of the total number of accounts (252.6 crore), as against the international benchmark of 80 per cent. In terms of amount, the total insured deposits of ₹76,21,258 crore as at end-March 2021 constituted 50.9 per cent of assessable deposits of ₹1,49,67,776 crore, as against the international benchmark of 20 - 30 per cent. At the current level, insurance cover is around 4.0 times of per capita income in 2020-21.

VI.115 The DICGC builds up its Deposit Insurance Fund (DIF) from premia received from insured banks, interest income from investments and cash recovery out of assets of failed banks adjusting for expenditure by way of payment of claims of depositors and related expenses, net of taxes. This fund is available for settlement of claims of depositors of banks taken into liquidation/amalgamation. As per the un-audited data, size of the DIF stood at ₹1,29,936 crore as on March 31, 2021, yielding a reserve ratio of 1.70 per cent.

VI.116 Five cooperative banks and one LAB were liquidated during the year 2020-21. As per the un-audited data, the Corporation has processed claims amounting to ₹993 crore during 2020-21 with a view to ensuring payment to insured depositors of liquidated banks under the prevailing pandemic situation. Of ₹993 crore, the Corporation has settled claims amounting to ₹564 crore in respect of nine co-operative banks during 2020-21. An amount of ₹330 crore has been settled in case of one cooperative bank in April 2021. However, the net outgo of funds towards settlement of claims

from the Corporation was also lower as there was a recovery of ₹ 568 crore during 2020-21. There was an amalgamation of a private sector bank and a foreign bank during 2020-21.

VI.117 Deposit insurance constitutes an integral part of the financial safety net across the world. The positive impact of deposit insurance on financial stability and the moral hazard associated with pricing of deposit insurance have gained importance in recent times (Box VI.6). The risk

arising from financial intermediation by banks is addressed through regulation and supervision, central bank emergency liquidity and deposit insurance, with the first element, *i.e.*, regulation and supervision acting as the first line of defence in safeguarding financial stability, emergency liquidity from the central bank to banks being an intermediate/transitional pillar and deposit insurance maintaining the confidence of the public in the banking system.

Box VI.6

Deposit Insurance Pricing - Mitigating Moral Hazard through Risk-based Premium (RBP)

In order to maintain an adequate level of deposit insurance, the DICGC collects premium from member financial institutions either at a flat rate or a differentiated rate on the basis of an individual bank's risk profile. Although flat rate premium systems have the advantage of being relatively easy to understand and administer, they do not take into account the level of risk that a bank poses to the deposit insurance system and can be perceived as unfair in that the same premium rate is charged to all banks regardless of their risk profile [International Association of Deposit Insurers (IADI), 2011]. The primary objective of a differential premium system is to provide incentives for banks to avoid excessive risk taking and introduce more fairness into premium assessment processes. Keeping this objective in view, many jurisdictions are transiting towards RBP, with the Federal Deposit Insurance Corporation (FDIC) being among the earliest to adopt the practice (1993). The IADI's Annual Survey conducted in 2020 reveals that 60 DIS use flat rate premium, 41 DIS use RBP, while 9 DIS use a combination of both the systems.

The literature on pricing of deposit insurance identifies different approaches for determining RBP, *viz.*, the option pricing model; expected loss pricing method; bucketing approach; and deposit insurance fund size estimation. In order to estimate bank risk and to set deposit insurance premiums, regulators in many jurisdictions use a combination of qualitative indicators along with CAMEL (Capital, Asset Quality, Management, Earnings, and Liquidity) indicators (IADI, 2020). In the case of FDIC for instance, an insured institution's assessment rate is based primarily on two measures of risk: capital levels and supervisory ratings. The capital measure assigns institutions to one of three capital groups: well capitalised;

adequately capitalised; or less than adequately capitalised (Garnett *et al.*, 2020).

In India, several committees, including the Narasimham Committee on Banking Sector Reforms (1998) and the Capoor Committee on Reforms in Deposit Insurance in India (RBI, 1999) have recommended RBP. The Committee on Credit Risk Model (2006) constituted by the DICGC and the Committee on Differential Premium Systems (2015) also recommended RBP but could not operationalise it as the roll out was linked with hike in deposit insurance cover. With effect from February 4, 2020, deposit insurance cover was increased to ₹5 lakh from the earlier limit of ₹1 lakh. With a view to mitigating the impact of the hike in the cover in case of failure of banks, the premium rate was also increased to 12 paise per ₹100 of deposits from April 1, 2020 from 10 paise earlier. The introduction of RBP in order to address the issue of moral hazard inherent in flat rate premium is a natural corollary. The Internal Committee on RBP (Chairman: Shri V. G. Venkata Chalapathy) undertook the risk assessment of banks, primarily based on CAMEL parameters and recommended the introduction of RBP. Recommendations of the Internal Committee are currently under consideration for their implementation.

References:

1. Garnett, E., Henry L.V., Hoople, D. & Mihalik, A. (2020), 'A History of Risk-Based Premiums at the FDIC', *FDIC Staff Study*, January.
2. IADI (2011), 'General Guidance for Developing Differential Premium Systems', October.
3. IADI (2020), 'Evaluation of Differential Premium Systems for Deposit Insurance', August.

6. CONCLUSION

VI.118 In sum, additional regulatory measures were adopted, apart from extending the existing ones, in response to the disruptions in the financial system owing to COVID-19 pandemic. Steps were taken for increasing credit flow to corporates and small business segment. Measures were also undertaken to strengthen regulatory and supervisory framework of SCBs, cooperative banks and NBFCs in line with the global best practices, and also with an objective to bring them under uniform enforcement framework to minimise the

policy arbitrage. Measures to harness technology for efficient customer services and effective fraud detection were also put in place. Implementing IO scheme in select NBFCs, moving towards 'One Nation - One Ombudsman' approach to improve the efficacy of ombudsman schemes and instituting a comprehensive framework to strengthen grievance redress mechanism reflected the resolve to ensure consumer protection. As such, strengthening regulation and supervision in several small and big steps continues to be in focus and this will contribute to bolstering the system stability.