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# Statement on Developmental and Regulatory Policies
# Reserve Bank of India

This Statement reviews the progress of various developmental and regulatory policy measures announced by the Reserve Bank in recent policy statements and sets out new measures for further refining the liquidity management framework; strengthening the banking regulation and supervision; broadening and deepening financial markets; and extending the reach of financial services by enhancing the efficacy of the payment and settlement systems.

## I. Liquidity Management Framework for Monetary Policy Operations

2. The liquidity management framework was modified in April 2016, providing assurance on both durable and frictional liquidity, while aiming to progressively lower the average *ex-ante* liquidity deficit in the system to a position closer to neutrality. Consistent with this assurance, the RBI proactively injected durable liquidity of ₹ 2.1 trillion during the year up to November 8, 2016 in the form of open market purchase operations, net forex market operations, and buyback of government securities. This helped in bringing down the system level *ex-ante* liquidity position from a deficit of about ₹ 813 billion in Q1 on a daily average basis to a surplus of ₹ 292 billion in Q2 and ₹ 64 billion in Q3 (up to November 8, 2016).

3. Following demonetisation, a persistent large structural liquidity surplus has impacted the banking system. The Reserve Bank has absorbed the surplus liquidity using a mix of both conventional and unconventional instruments to ensure that the money market rates remain aligned to the repo rate. With the gradual decline in the magnitude of the surplus from its peak in early January and due to expiration of securities authorised under the MSS, the Reserve Bank has progressively moved to variable rate reverse repo operations for absorbing surplus liquidity, some of which may persist through 2017-18.

**4. Management of Surplus Liquidity -** The Reserve Bank is committed to reverting system liquidity to a position closer to neutrality, consistent with the stance of monetary policy. Towards this goal, the Reserve Bank will employ a mix of instruments to ensure that all normal requirements of liquidity consistent with the growing economy will be met:

- The expansion in currency in circulation will progressively drain away some of the surpluses associated with demonetisation, while remaining effects will be managed with variable reverse repo auctions with a preference for longer term tenors.

- Operations under the Market Stabilisation Scheme (MSS) using Treasury Bills and dated securities will be conducted to modulate liquidity from other sources.
- If required, durable liquidity will be managed through open market operations (OMO sales and purchases) with a view to moving system level liquidity to neutrality.
- Enduring surpluses due to government operations will be managed by issuances of cash management bills (CMBs) of appropriate tenors in accordance with the memorandum of understanding with the Government of India.
- Fine tuning operations in the form of variable rate repo/reverse repo auctions of various maturities will continue to be deployed to modulate day-to-day liquidity.

5. The Reserve Bank has proposed since November 2015 the introduction of a Standing Deposit Facility (SDF) by suitably amending the RBI Act, which is under examination of the Government. Introduction of this facility would give greater flexibility to the Reserve Bank for managing its liquidity operations.

**6. Narrowing of the Monetary Policy Rate Corridor –** In consonance with the recommendation of the Expert Group to Revise and Strengthen the Monetary Policy Framework (Chairman: Dr. Urjit R. Patel), the policy rate corridor was narrowed from +/-100 bps to +/- 50 bps in April 2016, with a view to ensuring finer alignment of the weighted average call rate (WACR), the operating target of monetary policy, with the repo rate. In either extremely tight liquidity conditions or in situations of persistent excess liquidity, when most market participants are on one side of the market for overnight liquidity, a narrower corridor can contribute to finer alignment of the operating target with the policy rate. Accordingly, it has been decided to narrow the policy rate corridor around the policy repo rate to +/-25bps from +/- 50bps with immediate effect. As a result, the reverse repo rate under the liquidity adjustment facility (LAF) would be 25 bps lower than the policy repo rate and the marginal standing facility (MSF) rate would be 25 bps higher than the policy repo rate.

**7. Substitution of Collateral under the LAF Term Repos** - Currently, there is no provision for LAF participants to substitute the security offered as collateral to the Reserve Bank under term repos. It has been decided to allow substitution of collateral by market participants in the term repos under the LAF which will provide operational flexibility to them by enhancing liquidity of collaterals. This functionality will be available from April 17, 2017.

## II. Banking Regulation and Supervision

**8. Revised Prompt Corrective Action (PCA) Framework for Banks -** Based on the recommendations of the Sub-Committee of Financial Stability and Development Council (FSDC-SC), the existing PCA framework for banks has been reviewed, updated and finalised with the approval of the Board for Financial Supervision (BFS). Indicators, which will trigger the updated PCA, include capital [capital-to-risk weighted assets ratio (CRAR) and common equity tier 1 (CET1) ratio], net non-performing assets (NPA) ratio and return on assets. Leverage would be monitored additionally. The banks under PCA would be required to conform to such mandatory and discretionary actions as may be decided by the Reserve Bank. The revised PCA framework for banks will be issued by mid-April 2017.

**9. Asset Reconstruction Companies(ARCs): Raising the Minimum Level of Net Owned Funds (NOF) -** While the earlier provision in the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 of a minimum of '₹ 2 crore of owned funds' was amended in 2016 as '₹ 2 crore of net owned funds (NOF)', the cap on owned fund of 15 per cent of financial assets was removed. In view of the enhanced role of ARCs and greater cash based transactions, it is proposed to stipulate a minimum NOF of ₹100 crore for ARCs. The necessary instructions will be issued by end-April, 2017.

**10. Partial Credit Enhancement (PCE): Capital Requirement -** It is proposed that if the pre-enhancement rating of the PCE enhanced bond subsequently improves over the rating at the time of issuance, the capital calculated will be as per the prevailing difference in pre- and post-enhancement rating and it will not be subject to either the extant floor (the capital requirement on the PCE at the time of issuance of the PCE enhanced bonds) or the restriction of maintaining the number of notches of improvement in rating at the time of issuance. The necessary instructions will be issued by end-April, 2017. It is also proposed that in order to be eligible for PCE by banks, the bonds will have to be rated by two credit rating agencies accredited by the Reserve Bank.

**11. Banking Outlets: Final Guidelines -** Final guidelines are proposed to be issued on banking outlets, clarifying on what is a 'banking outlet' and harmonising the treatment of different forms of bank presence for the purpose of opening outlets in underserved areas. These will supersede the branch licensing guidelines in force. Detailed guidelines will be issued by end-April, 2017.

**12. Real Estate Investment Trust (REITS) and Infrastructure Investment Trust (InvITs): Banks' Participation –** The Securities and Exchange Board of India (SEBI) has put in place regulations for REITS and InvITs and requested the Reserve Bank to allow banks to participate in these schemes. Currently, banks are allowed to invest in equity-linked mutual funds, venture capital funds (VCFs) and equities to the extent of 20 percent of their NOF. It is proposed to allow banks to invest in REITS and InvITs within this umbrella limit. Detailed guidelines will be issued by end-May 2017.

**13. Countercyclical Capital Buffer -** The framework on countercyclical capital buffer (CCCB) was put in place by the Reserve Bank in terms of guidelines issued on February 5, 2015 wherein it was advised that the CCCB would be activated as and when the circumstances warranted, and that the decision would normally be pre-announced with a lead time of four quarters. The framework envisages the credit-to-GDP gap as the main indicator, which may be used in conjunction with other supplementary indicators, *viz.*, the Credit-Deposit (C-D) ratio for a moving period of three years (given its correlation with the credit-to-GDP gap and GNPA growth), industrial outlook (IO) assessment index (with due note of its correlation with GNPA growth), and interest coverage ratio (noting its correlation with the credit-to-GDP gap).Based on the review and empirical testing of CCCB indicators, it has been decided that it is not necessary to activate CCCB at this point in time.

## III. Financial Markets

**14. Simplified Hedging Facility for Forex Exposure: Draft Guidelines –** On August 25, 2016, the Reserve Bank announced a scheme to permit entities exposed to exchange rate risk, whether resident or non-resident, to undertake hedging transactions with simplified procedures up to a limit of USD 30 million at any given time. Draft guidelines on the proposed scheme are being placed in the public domain for wider feedback by mid-April, 2017.

**15. Introduction of Tri-party Repo: Draft Framework -** As recommended by the Working Group on Development of Corporate Bond Market in India (Chairman: Shri

HR Khan), a draft policy framework for introduction of tri-party repo is being placed in the public domain by mid-April, 2017.

## IV. Payment and Settlement

**16. Introduction of Additional Settlement Batches for National Electronic Funds Transfer (NEFT) -** As envisaged in the document on Vision-2018 for Payment and Settlement Systems, the NEFT settlement cycle will be reduced from hourly batches to half hourly batches. Consequently, 11 additional settlement batches will be introduced at 8.30 am onwards, taking the total number of half hourly settlement batches during the day to 23. This will enhance the efficiency of the NEFT system and add to customer convenience. The starting batch at 8.00 am and closing batch at 7.00 pm shall remain the same, as hitherto. The return discipline shall also remain the same, *i.e.,* B+2 hours (settlement batch time plus two hours) as per the existing practice.

**17. Merchant Discount Rate (MDR): Rationalisation -** The Reserve Bank issued a draft circular on "Rationalisation of Merchant Discount Rate (MDR) for Debit Card Transactions" on February 16, 2017. The extensive feedback received, including from the Government, banks, card networks, the Indian Banks' Association, the Payments Council of India, private entities and individuals are being examined. Until the issuance of final guidelines, the extant instructions on MDR for debit card transactions will continue to apply.

**18. Issuance and Operation of Pre-paid Payment Instruments (PPIs) in India -** The Reserve Bank had issued a draft circular on "Master Directions on Issuance and Operation of Pre-paid Payment Instruments (PPIs) in India" on March 20, 2017 with the deadline for comments as March 31, 2017. Based on the requests received from various quarters, the timeline for feedback/comments has been extended until April 15, 2017. The final guidelines for PPIs would be issued by end- May 2017.

## V. Financial Inclusion

**19. Pilot Project on Financial Literacy: Centres for Financial Literacy (CFL) -** The Reserve Bank is initiating a pilot project on financial literacy at the block level to explore innovative and participatory approaches to financial literacy. The pilot project will be commissioned in nine states across 80 blocks by Non-Government Organisations (NGOs) in collaboration with the sponsor banks. Six NGOs registered with the Depositor Education and Awareness Fund, *viz*., CRISIL Foundation, Mumbai; Dhan Foundation; Swadhaar Fin Access, Mumbai; Indian School of Micro Finance for Women (ISMW); Samarpit, Chhattisgarh; and the PACE Foundation have been selected to execute the pilot project in collaboration with banks. The pilot project would be executed with the following broad objectives: active saving and good borrowing; financial planning and goal setting; and, going digital and consumer protection. The CFLs would be set up under a common name and logo, "Money-wise Centre for Financial Literacy". The sponsor banks will enter into contracts with the identified NGOs within three months, *i.e.,* by June 30, 2017. Thereafter, the NGOs will start operating the CFLs within three months of entering into contracts with banks.

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