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Statement on Developmental and Regulatory Policies

This Statement sets out various developmental and regulatory policy measures for strengthening regulation and supervision; broadening and deepening financial markets; improving currency and debt management; fostering innovation in payment and settlement system; and, facilitating data management.

I. Regulation and Supervision

1. Increase in Liquidity Coverage Ratio (LCR) carve-out from Statutory Liquidity Ratio (SLR)

As per the existing roadmap, scheduled commercial banks have to reach the minimum Liquidity Coverage Ratio (LCR) of 100 per cent by January 1, 2019. Presently, the assets allowed as Level 1 High Quality Liquid Assets (HQLAs) for the purpose of computing LCR of banks include, *inter alia*, Government securities in excess of the minimum SLR requirement and, within the mandatory SLR requirement, Government securities to the extent allowed by the Reserve Bank under Marginal Standing Facility (MSF) [presently 2 per cent of the bank's NDTL] and under Facility to Avail Liquidity for Liquidity Coverage Ratio (FALLCR) [presently 9 per cent of the bank's NDTL]. For the purpose of computing LCR, it has been decided that, in addition to the above-mentioned assets, banks will be permitted to reckon as Level 1 HQLAs Government securities held by them upto another 2 per cent of their NDTL under FALLCR within the mandatory SLR requirement. Hence, the total carve-out from SLR available to banks would be 13 per cent of their NDTL. The other prescriptions in respect of LCR remain unchanged.

2. Valuation of State Government Securities

As per extant guidelines on prudential norms for classification, valuation and operation of investment portfolio by banks, the state government securities are valued applying the Yield to Maturity (YTM) method with a uniform mark-up of 25 basis points above the yield of the Central Government securities (G-Secs) of equivalent maturity.

It has now been decided that the securities issued by each state government should be valued based on observed prices. The valuation of traded state government securities shall be at the price at which they have been traded in the market. In case of non-traded state government securities, the valuation shall be based on the state-specific weighted average spread over the yield of the central government securities of equivalent maturity, as observed at primary auctions. The detailed guidelines to this effect will be issued separately by June 20, 2018.

3. Spreading of MTM losses

In the wake of spurt in the yields of government securities, banks were given an option to spread, over four quarters, the mark-to-market losses recorded on their investment portfolio during the quarters ended December 2017 and March 2018. It was also required that banks build an Investment Fluctuation Reserve (IFR) of 2 percent of their holdings in the AFS and HFT categories to avoid such eventualities. In view of the continuing rise in yield of government securities as also the inadequacy of time to build IFR for many banks, it has been decided to grant banks the option to spread the mark-to-market (MTM) losses on investments held in Available for Sale (AFS) and Held for Trading (HFT) portfolio for the quarter ending June 30, 2018, equally over a period of four quarters, commencing from the quarter ending June 30, 2018. The circular in this regard will be issued within a week.

4. Voluntary Transition of Urban Cooperative Banks into Small Finance Banks

The High Powered Committee on Urban Cooperative Banks (UCB), chaired by Shri R. Gandhi, the then Deputy Governor of Reserve Bank, had, *inter alia*, recommended the voluntary conversion of large Multi-State UCBs into Joint Stock Companies and other UCBs which meet certain criteria into Small Finance Banks (SFBs). Taking these recommendations into consideration, it has been decided to allow voluntary transition of UCBs meeting the prescribed criteria into SFBs. The detailed scheme will be announced separately.

5. Encouraging formalisation of the MSME Sector

In February 2018, banks and NBFCs were allowed to temporarily classify their exposures to the Goods and Services Tax (GST) registered Micro, Small and Medium Enterprises (MSMEs), having aggregate credit facilities from these lenders up to ₹250 million, as per a 180 day past due criterion, subject to certain conditions. This was done with a view to ease the transition of MSMEs to the formalised sector post their registration under the GST.

Having regard to the input credit linkages and associated issues, it has now been decided to temporarily allow banks and NBFCs to classify their exposure, as per the 180 day past due criterion, to all MSMEs with aggregate credit facilities up to the above limit, including those not registered under GST. Accordingly, eligible MSME accounts, which were standard as on August 31, 2017, shall continue to be classified as standard by banks and NBFCs if the payments due as on September 1, 2017 and falling due thereafter up to December 31, 2018 were/are paid not later than 180 days from their original due date.

In view of the benefits from increasing formalisation of the economy for financial stability, the 180 day past due criterion, in respect of dues payable by GST registered MSMEs from January 1, 2019 onwards, shall be aligned to the extant norm of 90 day past due in a phased manner, whereas for entities that do not get registered under GST by December 31, 2018, the asset classification in respect of dues payable from January 1, 2019 onwards shall immediately revert to the 90 day norm.

Detailed guidelines are being issued separately.

6. Convergence of Priority Sector Lending (PSL) guidelines for housing loans with Affordable Housing definition under Pradhan Mantri Awas Yojana

In order to bring greater convergence of the Priority Sector Lending guidelines for housing loans with the Affordable Housing Scheme, and to give a fillip to the low-cost housing for the Economically Weaker Sections and Lower Income Groups, it has been decided to revise the housing loan limits for PSL eligibility from existing ₹28 lakh to ₹35 lakh in metropolitan centres (with population of ten lakh and above), and from existing ₹20 lakh to ₹25 lakh in other centres, provided the overall cost of the dwelling unit in the metropolitan centre and at other centres does not exceed ₹45 lakh and ₹30 lakh, respectively. A circular in this regard shall be issued by June 30, 2018.

7. Emerging Developments in Low Ticket Housing

After a careful analysis of the Housing Loans data, it has been observed that the level of NPAs for the ticket size of up to Rupees two lakh has been high and is rising briskly. Banks need to strengthen their screening and follow up in respect of lending to this segment in particular. The Reserve Bank is closely monitoring this sector and will consider appropriate policy response such as a tightening of the LTV ratios and/or an increase in the risk weights, should the need arise.

8. Permitting Core Investment Companies to invest in Infrastructure Investment Trusts (InvITs) as Sponsors

Core Investment Companies (CICs) registered with the Reserve Bank as Non-Bank Financial Companies (NBFCs) primarily invest in group companies and do not carry out any other NBFC activity. They are required to invest in group companies in the form of equity shares, preference shares, bonds, debentures, debt or loans, at least up to 90 per cent of their net assets, while equity investments in group companies must constitute at least 60 per cent of net assets. In order to promote infrastructure development through investment in InvITs, it has been decided to enable CICs to act as sponsors to InvIT issuances and permit them to reckon their holdings of InvIT units as sponsors as part of the sub-limit of 60 percent for equity investments in group companies. Exposure of such CICs towards InvITs shall be limited to their holdings as sponsors and shall not, at any point in time, exceed the minimum limit in terms of amount and tenor prescribed in this regard by Securities and Exchange Board of India (SEBI) (Infrastructure Investment Trusts) Regulations, 2014. Necessary instructions will be issued within a week.

II. Financial Markets

9. Harmonising Liquidity Adjustment Facility (LAF) Haircuts with International Standards

Presently, the Reserve Bank provides Rupee liquidity to market participants through the Repo/Marginal Standing Facility (MSF) window against eligible collateral. An initial margin of 4 per cent and 6 per cent is currently applied on Central Government Securities (including T-bills) and State Development Loans (SDLs) respectively, submitted as collaterals by participants in Repo/MSF. Since the margin requirement is similar for all eligible securities irrespective of residual maturity, the prevailing system does not differentiate the market risk across securities.

On a review and in line with international standards, it has been decided to require — starting August 1, 2018 — initial margin on collateral on the basis of its residual maturity. The initial margin requirement for Central Government Securities would be in the range of 0.5 per cent to 4 per cent in five different buckets of residual maturity. The initial margin requirement in case of SDLs would be in the range of 2.5 per cent to 6.0 per cent for the same maturity buckets. With a view to incentivising the State Governments to get SDLs a public rating, it has been decided that the initial margin requirement for rated SDLs shall be set at 1.0 per cent lower than that of other SDLs for the same maturity buckets, i.e., in the range of 1.5 per cent to 5.0 per cent. A circular in this regard will be issued today.

10. Enhancing participation in Government Securities Market

(i) Short Sale in Government Securities

Short sale in Central Government Securities (G-Secs) was introduced in February 2006 to provide participants with a tool to express two-way view on interest rates and thereby enhance price discovery. Currently, scheduled commercial banks, primary dealers and certain well-managed Urban Cooperative Banks (UCBs) are permitted to undertake short sale transactions. There are entity-wise and (liquid or illiquid) security-wise limits for undertaking short sale transactions. With an objective to deepen further the G-Sec and repo market, it is proposed to liberalise the eligible short sale participants' base as well as relax the entity-wise and security category-wise limits for short selling in G-Sec. A circular in this regard will be issued by the end of June 2018.

(ii) When issued market in Government Securities

The 'when issued' (WI) market in the Central Government Securities (G-Secs) was introduced in May 2006, in light of the Fiscal Responsibility and Budget Management (FRBM) Act 2003, to strengthen the debt issuance framework via better management and distribution of auction risk. Currently, long positions in the WI market can be taken by anyone eligible to participate in an auction, while only banks and primary dealers (PDs) are allowed to take short positions. Further, short position of banks and PDs is capped at 5 per cent of the issue amount. Participations norms have been gradually eased. With an objective to deepen further the G-Secs market, it is proposed to liberalise the eligible participants' base and relax the entity-wise limits for taking positions in the when issued market. A circular in this regard will be issued by the end of June 2018.

11. Expanding Activities of Standalone Primary Dealers

Standalone Primary Dealers (SPDs) have been gradually permitted to diversify their activities beyond G-sec activities into alternate streams, within acceptable limits. In order to facilitate SPDs to provide comprehensive services to their FPI clients, it has been decided to provide the SPDs a limited Foreign Exchange licence. A circular in this regard shall be issued by the end of June 2018.

12. Market abuse regulations

Various regulatory initiatives are being steadily undertaken to increase activity and participation in financial markets and redistribute financial exposure of the banking system. Concomitantly, regulations to prevent abusive market practices need to be strengthened. Fixed Income Money Market and Derivatives Association of India (FIMMDA) has developed a fair practice code (FPC) for voluntary adoption by banks and other members. The Foreign Exchange Dealers' Association of India (FEDAI) has also adopted for market participants in the Indian Foreign Exchange (FX) market, the FX Global Code – a global code of conduct for the wholesale FX market that sets out principles to promote a robust, fair, liquid, open and appropriately transparent market, underpinned by high ethical standards. To take this process further, it is proposed to introduce regulations, in line with the best global practices, to prevent abuse in markets regulated by the Reserve Bank. Draft regulation for consultation will be issued by the end of August 2018.

13. Policy framework for Central Counter-parties

Central Counter-parties (CCPs) play a critical role in financial markets. CCPs provide guaranteed settlement services in the markets served by them and mitigate counterparty risk for the participants, thereby reducing systemic risk. In order that these entities function in an efficient and effective manner, the Reserve Bank will lay down the framework for the recognition of the foreign CCPs as also the capital requirement and governance framework for all CCPs. These directions will be issued by the end of July 2018.

III. Debt Management

14. Consolidated Sinking Fund and Guarantee Redemption Fund of State Governments

State Governments are maintaining the Consolidated Sinking Fund (CSF) and the Guarantee Redemption Funds (GRF) with the Reserve Bank as buffers for repayment of their liabilities. Currently, State Governments can avail of Special Drawing Facility (SDF) from the Reserve

Bank against the collateral of the funds in CSF and GRF. The rate of interest charged is 100 bps below the Repo Rate at which Ways and Means Advances are extended to the State Governments. In order to further incentivise adequate maintenance of these funds by the State Governments and to encourage them to increase the corpus of these funds, it has been decided to lower the rate of interest on SDF from 100 bps below the Repo Rate to 200 bps below the Repo Rate. A circular in this regard will be issued by June 30, 2018.

IV. Payment and Settlement

15. Authorisation of Payment Systems

With the maturing of the retail payments market, it is important that the concentration risk in retail payment systems is minimized from a financial stability perspective. The Reserve Bank plans to encourage more players to participate in and promote pan-India payment platforms so as to give a fillip to innovation and competition in the sector. A policy paper in this regard will be put out for public consultation by September 30, 2018.

V. Currency Management

16. Easing of Challenges faced by the Visually Challenged in using Indian Banknotes

The Reserve Bank has been sensitive to the challenges faced by the visually challenged in conducting their day to day business with Indian banknotes. While different fora have been consulted from time to time before making any change in the Indian banknotes, the Reserve Bank is of the view that technological progress has opened up new vistas for making Indian banknotes more recognizable for the visually challenged, facilitating their day to day transactions. Accordingly, it has been decided that the Reserve Bank, in consultation with various entities representing the visually challenged, will explore the feasibility of developing a suitable device or mechanism for aiding them in the identification of Indian banknotes. The Reserve Bank will issue necessary guidelines in this regard within six months.

VI. Data Management

17. High-level Task Force on Public Credit Registry

As indicated in the Statement on Developmental and Regulatory Policies of October 4, 2017, a High Level Task Force on Public Credit Registry (PCR) for India (Chairman: Shri Yeshwant M. Deosthalee) was constituted by the Reserve Bank to review the current availability of information on credit, the adequacy of existing information utilities, and identify gaps that could be filled by a PCR. The Task Force, which submitted its report on April 4, 2018, recommended that with a view to address information asymmetry, foster access to credit, and strengthen the credit culture in the economy, a PCR should be set up by the Reserve Bank. The Reserve Bank has considered the recommendations of the Task Force and decided to set up a PCR in a modular and phased manner. The report of the Task Force will be released for public on the Reserve Bank's website today. An Implementation Task Force (ITF) is being constituted by the Reserve Bank to help design undertake logistics for the next steps in setting up of the PCR.

18. Harmonisation of Data and Definitions for the Liberalised Remittance Scheme

Pursuant to the announcement made in the first bi-monthly Monetary Policy Statement 2018-19 on April 5, 2018, a system for daily reporting of individual transactions under the Liberalised Remittance Scheme (LRS) by Authorised Dealer (AD) banks has been put in place. This system enables the AD banks to view the remittances already sent by an individual during the financial year, thus improving monitoring and ensuring compliance with the LRS limits. Since the said reporting system uses the Permanent Account Number (PAN) of the remitter as a Unique Identifier to aggregate the remitter-wise data, it has been decided that furnishing of PAN, which hitherto was not to be insisted upon while putting through permissible current account transactions of upto USD 25,000, shall now be mandatory for making all remittances under LRS. Further, in the context of remittances allowed under LRS for maintenance of close relatives, it has been decided to align the definition of 'relative' with the definition given in Companies Act, 2013 instead of Companies Act, 1956.

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