Year-end considerations

Financial service sector supplement

Updates on standards, interpretations and regulatory considerations affecting financial statements

April 2025

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Foreword

India's diversified financial sector is undergoing rapid expansion both in terms of strong growth of existing financial services firms and new entities entering the market. Regulators are actively encouraging innovation and advancing financial accessibility, while also maintaining a vigilant stance on regulatory compliance and the protection of consumer rights within the fast-paced digital financial environment.

Indian financial institutions face pressing challenges such as a struggle in deposit mobilization in pace with growth in loan leading to increasing mismatch in Credit–to-deposit (CD) ratio, compression of net interest margin (NIM), rising delinquencies in unsecured borrowings, increased cybersecurity threats as digital adoption expands, and the potential impact of a global economic slowdown (due to tariff wars) on capital flows and trade financing. Financial institutions are expected to navigate these challenges by adapting to new trends and utilizing technology to boost operational efficiency and improve the customer experience.

It is imperative that financial institutions prioritize adherence to regulatory guidelines to preserve the integrity, security, and operational efficiency of their operations.

It is our constant endeavor to help entities stay updated with the latest developments and changes relevant for finance and regulatory reporting teams. As all entities gear up to finalize their financial statements for the year-ending 31 March 2025, it is critical that they evaluate all key changes in accounting and regulatory space which impact financial and regulatory reporting. This publication provides critical updates and insights to help finance leaders and teams update themselves with the changes applicable for the year-end closure and ensure that the companies are well prepared for the closure with the changes.

Purpose of this publication

This publication is the financial services sector supplement of our year-end reporting considerations publication which provides an overview of the changes in accounting standards and interpretations as well as regulatory changes up to 31 January 2025 which are relevant for financial year 2024-25 and beyond. It covers key changes which are relevant to the BFSI sector and provides a glance at the regulatory and other changes that have been issued during this year, which have a consequential impact on accounting, disclosures, and compliance with regulations. It does not attempt to cover all the regulatory pronouncements but covers the key changes impacting the financial year ending 31 March 2025 and beyond. This publication does not aim to provide an in-depth analysis or discussion on the changes, rather it aims to highlight the key aspects of these changes. Reference should be made to the text of the pronouncements before taking any decisions or actions.

The publication is divided into the following sections:

Section 1 Banks and Non-Banking Financial Company (NBFCs)

Section 2 Insurance

Hope you all find the publication useful.

Adarsh Ranka
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Banks and NBFCs

A Financial reporting and regulatory updates

1. Review of Risk Weights for Housing Finance Companies ('HFCs')

Circular Date: 12 August 2024

Effective Date: 12 August 2024

Applicability: HFCs

The Reserve Bank of India (RBI) issued a circular to modify the manner of computing Risk Weighted Assets (RWA) for certain loans issued by HFCs.

The circular mentions change to the following loan portfolio:

- **Undisbursed housing loans/ other loans:** On 17 February 2021, the RBI came out with Master Direction - Non-Banking Financial Company - Housing Finance Company (Reserve Bank) Directions, 2021 which govern majority activities related to HFCs. As per these directions, the RWAs calculated using Step 1 and Step 2 as follows:
  - Convert the notional amount of the transaction into a credit equivalent amount using either a credit conversion factor (CCF) or the current exposure method.
  - Multiply the credit equivalent amount by the corresponding Risk Weight, which varies depending on the counterparty.

The RWA computed would be limited to the RWA derived from a notional basis, corresponding to the equivalent amount of the disbursed loan.

The impact of the notification may be understood from the following computations:

Loan Sanctioned	LTV ratio	Risk Weight	Earlier RWA	Revised RWA	Impact
INR20 Lakh (Disbursed INR10 Lakh Undisbursed INR10 Lakh)	<=80%	35%	D: 10*35% = 3.5 UD: 10*50% = 5 Total = 8.5	D: 10*35% = 3.5 UD^: (a) 10*50%*100% = 5 or (b) 10*35% = 3.5, whichever is lower, i.e. 3.5 Total = 7	Positive Impact (Reduction in RWA)
	>80% <=90%	50%	D: 10*50% = 5 UD: 10*50% = 5 Total = 10	D: 10*50% = 5 UD^: (a) 10*50%*100% = 5 or (b) 10*50% = 5, whichever is lower, i.e. 5 Total = 10	No impact

^Applicable Risk Weight (RW) shall be lower of (a) RW, applying the credit conversion factor (CCF) (50%) on the undisbursed loan, with a 100% RW; and (b) the RW that will be applicable, based on the size and the LTV of the loan, if the undisbursed part were to be disbursed.

- **Commercial real estate:** Residential building: The Risk Weight of the loans (classified into fund-based and non-fund based) would be:
    - 75% – for classification ‘Standard’
    - 100% - for classification other than ‘Standard’.

How we see it

This circular predominantly focuses on Risk Weighted Assets and its calculations. It could have an impact on the way HFCs calculate capital requirement for loans to ensure that their risk exposure is adequately reflected. Ultimately, HFCs would be capping their RWA calculation on undisbursed housing loan and other similar loans, thereby increasing their capital adequacy ratio (CRAR). Further, stronger capital availability may increase HFCs’ ability to lend and absorb any unforeseen losses.

2. Review of regulatory framework for HFCs and harmonisation of regulations applicable to HFCs and NBFCs

Circular Date: 12 August 2024

Effective Date: 01 January 2025

Applicability:

- HFCs
- NBFCs

Following the transfer of HFC regulation from the National Housing Bank (NHB) to the RBI, a revised regulatory framework for HFCs was issued on 22 October 2020, to gradually harmonize the regulations for HFCs with those of NBFCs. In line with this objective, the RBI has conducted a review and now aims to align specific regulations for HFCs with the existing rules for NBFCs. The draft circular suggests revisiting certain guidelines for deposit-accepting NBFCs. This initiative is part of the ongoing effort to further synchronize the regulatory environment for HFCs with that of NBFCs.

Key Changes applicable to HFCs:

Sno.	Particulars	Guidelines of NBFC	Erstwhile regulation for HFCs	Amended / Harmonised Regulation for HFCs	Key changes
1	Maintenance of a minimum %age of liquid assets	*NBFC-D entities to invest and continuously maintain investments in unencumbered approved securities within India. The value of these securities, shall not exceed the prevailing market price, and the investment amount shall be at least 15% of public deposits at the close of business each day.	HFCs that accept deposits are required to maintain liquid assets equivalent to at least 13% of their public deposits.	Proposed to maintain liquid assets equal to 15% of their public deposits, as specified in the circular. Implementation in phased manner: 14% by 01 January 2025 and 15% by 01 July 2025.	The proposed change would impact HFCs liquidity management and financial strategies.
2	Safe custody of liquid assets	The Master Directions for deposit-taking NBFCs outlines detailed guidelines and requirements for the safe custody of liquid assets and the collection of interest on Statutory Liquidity Ratio (SLR) securities.	Deposit-taking HFCs to maintain liquid assets as per Section 29B of the NHB Act, and these assets shall be placed in safe custody with designated entities, as specified in Paragraph 40 of the HFC Directions.	The regulations on the safe custody of approved securities, as outlined in Paragraph 40 of the HFC Master Directions, have been repealed.	The HFCs may need to coordinate with specified custodians, reassess process systems to mitigate potential liquidity constraints, and ensure smooth interest collection on SLR securities.
3	Full cover for public deposits	NBFCs to ensure full asset cover for public deposits at all times. In the event of a shortfall, they are required to promptly notify the RBI.	HFCs to ensure full asset cover for public deposits at all times.	Under the proposed change, HFCs to ensure full asset cover for public deposits at all times. In the event of a shortfall, they are now required to notify NHB.	The proposed requirement for HFCs to maintain full asset cover for public deposits and report any shortfall to NHB enhances regulatory compliance obligations, impacting their operational and reporting processes.

Sno.	Particulars	Guidelines of NBFC	Erstwhile regulation for HFCs	Amended / Harmonised Regulation for HFCs	Key changes
4	Rating of deposits	NBFC-D entities cannot accept public deposits unless they secure a minimum investment grade or a specified credit rating for fixed deposits from an approved credit rating agency. This rating to be obtained annually, and a copy, along with the return on prudential norms, is to be submitted to the RBI.	HFCs cannot accept or renew public deposits without obtaining a minimum investment grade rating for fixed deposits from an approved credit rating agency. This rating to be renewed annually, with a copy submitted to the NHB. Additionally, HFCs to adhere to all prudential norms.	No change	No change
5	Ceiling on quantum of deposits	NBFC-D entities that comply with all prudential norms and maintain the required minimum Net owned funds (NOF) are allowed to accept public deposits up to 1.5 times their NOF.	Deposit-taking HFCs that meet all prudential norms and maintain a minimum investment-grade credit rating are permitted to accept public deposits up to three times their NOF.	The proposed adjustment seeks to limit the amount of public deposits they can hold to 1.5 times their NOF.	The proposed reduction in the cap on public deposits held by HFCs from 3 times to 1.5 times their NOF would significantly impact their funding capacity, potentially requiring a reassessment of their deposit mobilization strategies.
6	Period for repayment of public deposits	NBFCs are prohibited from accepting or renewing any public deposit unless the deposit is repayable after a minimum period of 12 months and no later than 60 months from the date of acceptance or renewal.	HFCs are permitted to accept or renew public deposits that are repayable after a minimum period of 12 months, but not later than 120 months from the date of acceptance or renewal.	Proposed that public deposits accepted or renewed by HFCs to be repayable after a minimum period of 12 months, but not later than 60 months.	This proposed change would standardize the maturity period for public deposits accepted or renewed by both NBFCs and HFCs.
7	Regulation on opening of branches and appointment of agents to collect deposits	Compliance with these regulations includes obtaining prior approval from the RBI for the establishment of new branches, adhering to restrictions or prohibitions on the appointment of agents, and submitting reports to the RBI regarding any new branch openings or agent appointments	No such extant regulations for HFCs.	The instructions outlined in Paragraph 30 of the Master Direction - NBFC Acceptance of Public Deposits (Reserve Bank) Directions, 2016, shall apply mutatis mutandis to deposit-taking HFCs.	This ensures that both NBFC-Ds and deposit-taking HFCs follow similar guidelines regarding the opening of branches or the appointment of agents.

Sno.	Particulars	Guidelines of NBFC	Erstwhile regulation for HFCs	Amended / Harmonised Regulation for HFCs	Key changes
8	Restrictions on investments in unquoted shares	NBFC-Ds are permitted to invest in unquoted shares of another company, provided that the company is neither a subsidiary nor part of the same group as the NBFC-D. The investment in such unquoted shares is limited to a maximum of 20% of the NBFC-D's owned funds.	No such extant guidelines for limits in investment in unquoted shares.	Under the proposed changes, deposit-taking HFCs will be required to establish Board-approved internal limits, while still adhering to the overall limit on direct investments. These internal limits will specifically apply to investments in unquoted shares of another company that is neither a subsidiary nor part of the same group as the HFC.	This amendment is intended to strengthen control and governance over HFCs' investments in unquoted shares.
9	Participation in Currency Futures	NBFCs are allowed to participate as clients in currency futures exchanges recognized by Securities and Exchange Board of India (SEBI). However, their participation is subject to RBI guidelines and to make the required disclosures in their balance sheets as per SEBI guidelines.	No such extant guidelines for participation of HFCs in currency futures.	HFCs are now allowed to participate in currency futures exchanges, provided they adhere to the guidelines set by the Foreign Exchange Department of the RBI and make the necessary disclosures in their balance sheets as per SEBI guidelines.	This change expands the range of financial instruments available to HFCs for hedging against currency fluctuations.
10	Participation in Currency Options and Interest Rate Futures (IRF)	NBFCs are permitted to participate as clients in currency option and IRF exchanges recognized by SEBI, provided they follow the guidelines issued by the RBI, and their participation is solely for hedging their underlying forex exposures. Non-deposit-taking NBFCs to make the required disclosures in their balance sheets as per SEBI guidelines.	No such extant guidelines for participation of HFCs in currency options.	Non-deposit-taking HFCs with an asset size of INR1000 crore or more are now allowed to participate in currency options exchanges and IRF, subject to the guidelines issued by the Foreign Exchange Department of the RBI and the necessary disclosures in their balance sheets in accordance with SEBI guidelines.	This change gives non-deposit-taking HFCs with an asset size of INR1000 crore and above an additional financial instrument to manage currency risk and interest rate risk, providing greater flexibility in their risk management strategies.

Sno.	Particulars	Guidelines of NBFC	Erstwhile regulation for HFCs	Amended / Harmonised Regulation for HFCs	Key changes
11	Credit Default Swaps (CDS)	NBFCs are permitted to participate in the CDS market solely as users, allowing them to buy credit protection exclusively for hedging the credit risk associated with corporate bonds they hold and ensure compliance with all required guidelines.	No such extant guidelines for participation of HFCs in CDS.	HFCs are allowed to participate in the CDS market exclusively as users, purchasing credit protection solely to hedge the credit risk on corporate bonds they hold and ensure compliance with required guidelines.	This provides HFCs with a new tool for credit risk mitigation, while ensuring compliance with regulatory requirements and maintaining strong governance.
12	Issue of co-branded credit cards	NBFCs are selectively permitted to issue co-branded credit cards in collaboration with scheduled commercial banks, without risk sharing, subject to prior approval from the RBI. This permission is granted for an initial period of two years, after which a review will be conducted. NBFCs to meet minimum eligibility criteria and follow the guidelines outlined in Annex XVII of the Scale Based Regulations (SBR) Master Directions.	No such extant guidelines for participation of HFCs in the business of credit cards.	HFCs may be selectively allowed to issue co-branded credit cards with scheduled commercial banks, without risk sharing, subject to prior approval from the RBI.	This proposed amendment creates new opportunities for HFCs in the credit card market, allowing them to collaborate with banks.
13	Finalization of financial statements	Each NBFC to finalize its financial statements within 3 months from the date they pertain to.	No such time limit for HFCs to finalize the financial statements.	It has been decided that HFCs to finalize their balance sheets within 3 months from the date they pertain to.	This proposed change is expected to streamline the financial reporting process for HFCs, potentially impacting their internal procedures, resource allocation, and overall financial management strategies to comply with the new timeline requirements.

Sno.	Particulars	Guidelines of NBFC	Erstwhile regulation for HFCs	Amended / Harmonised Regulation for HFCs	Key changes
14	Periodicity of Information System Audit ('IS Audit')	The frequency of IS audits shall be as per the IS audit policy of the NBFC.	IS Audit was required to be conducted at least once in 2 years.	The frequency of IS audits shall be as per the IS audit policy of the HFCs.	This proposed change will give HFCs greater flexibility in determining the frequency of IS audits, based on their internal policies and risk management factors.
15	Technical specifications for all participants of Account Aggregator ecosystem	NBFCs, whether acting as a 'Financial Information Provider' or 'Financial Information User,' are required to adopt the technical specifications published by (Reserve Bank Information Technology Private Limited) ReBIT.	No such extant guidelines for technical specifications issued.	HFCs, whether acting as a 'Financial Information Provider' or 'Financial Information User,' are required to adopt the technical specifications published by ReBIT.	The introduction of previously absent technical specifications now requires HFCs to align with standardized guidelines, which may impact their technological infrastructure, systems, and processes to ensure compliance.
16	Investment through Alternative Investment Fund (AIF)	Investments, loans, and exposures to subsidiaries, companies within the same group, and other NBFCs, exceeding 10% of the aggregate paid-up equity capital and free reserves, are deducted when calculating the NOF. In this context, investments made by the NBFC in entities within the same group, whether directly or indirectly through an AIF, will be treated similarly. This applies when the funds in the AIF (company) come from the NBFC to the extent of 50% or more, or when the beneficial owner of the AIF (trust) is the NBFC, and 50% of the funds in the trust are from the NBFC.	Investments, loans, and exposures to subsidiaries, companies within the same group, and other HFCs, exceeding 10% of the owned fund, are deducted from the owned fund to determine the NOF of an HFC.	Investments made by an HFC in entities within the same group, whether directly or indirectly, such as through an Alternative Investment Fund (AIF), shall be treated similarly. This applies if the funds in the AIF (company) come from the HFC to the extent of 50% or more, or if the beneficial owner of the AIF (trust) is the HFC and 50% of the funds in the trust are provided by the HFC.	This adopts a see-through approach for capturing investments made into entities through AIFs.

*NBFC-D: Deposit taking NBFC.

3. Fair Practices Code for Lenders – Charging of Interest

Circular Date: 29 April 2024

Effective date: 29 April 2024

Applicability: Regulated entities (REs):

- Commercial Banks [including Small Finance Banks (SFBs), Local Area Banks, and Regional Rural Banks (RRBs)] excluding Payments Banks
- All Primary (Urban) Co-operative Banks (UCBs)/ State Co-operative Banks (StCBs)
- District Central Co-operative Banks
- All NBFCs (including Microfinance Institutions and HFCs)

The RBI issues Fair Practices Code for lenders, addressing unfair interest charging practices.

Unfair practices undertaken by lenders

The RBI came across instances of lenders resorting to certain unfair practices in charging of interest. Some of the unfair practices observed are briefly explained below:

- Charging of interest from the date of sanction of loan or date of execution of loan agreement and not from the date of actual disbursement of the funds to the customer. Similarly, in the case of loans being disbursed by cheque, instances were observed where interest was charged from the date of the cheque whereas the cheque was handed over to the customer several days later.
- In the case of disbursal or repayment of loans during the course of the month, some REs were charging interest for the entire month, rather than charging interest only for the period for which the loan was outstanding.
- In some cases, it was observed that REs were collecting one or more instalments in advance but reckoning the full loan amount for charging interest.

The RBI directions

- The above mentioned and other such non-standard practices of charging interest are not in consonance with the spirit of fairness and transparency while dealing with customers. RBI through its supervisory teams has advised REs to refund such excess interest and other charges to customers. REs are also being encouraged to use online account transfers in lieu of cheques being issued in a few cases for loan disbursal.
- Therefore, in the interest of fairness and transparency, the RBI has directed all REs to review their practices regarding mode of disbursal of loans, application of interest and other charges and take corrective action, including system level changes, as may be necessary, to address the issues highlighted above.

How we see it

Entities should uphold fair business practices while dealing with customers. Entities shall clearly define interest calculation methods in loan agreements to prevent misinterpretation. Deploy robust loan management systems (LMS) to adopt automated systems or enhance the systems in place. This will help accurately compute interest based on the loan tenure and disbursement dates and adjust for foreclosure, overdue payments. It is imperative that interest on loans is levied in a manner that is equitable, transparent, and ethical, safeguarding consumer rights and upholding financial probity. Entities shall also conduct periodic internal audits or establish an independent review mechanism to ensure interest calculation and loan disbursement policies align with regulatory guidelines.

4. Key Facts Statement (KFS) for Loans & Advances

Circular Date: 15 April 2024

Effective Date: 01 October 2024

Applicability: Regulated Entities (REs):

- All Commercial Banks (including SFBs, Local Area Banks and RRBs, excluding Payments Banks)
- All Primary UCBs, StCBs, and Central Co-operative Banks
- All NBFCs (including HFCs)

The circular aims to standardize the Key Facts Statement (KFS) for loans and advances across various REs. The purpose of harmonizing these instructions is to increase transparency, reduce information asymmetry, and empower borrowers to make more informed decisions when taking out loans.

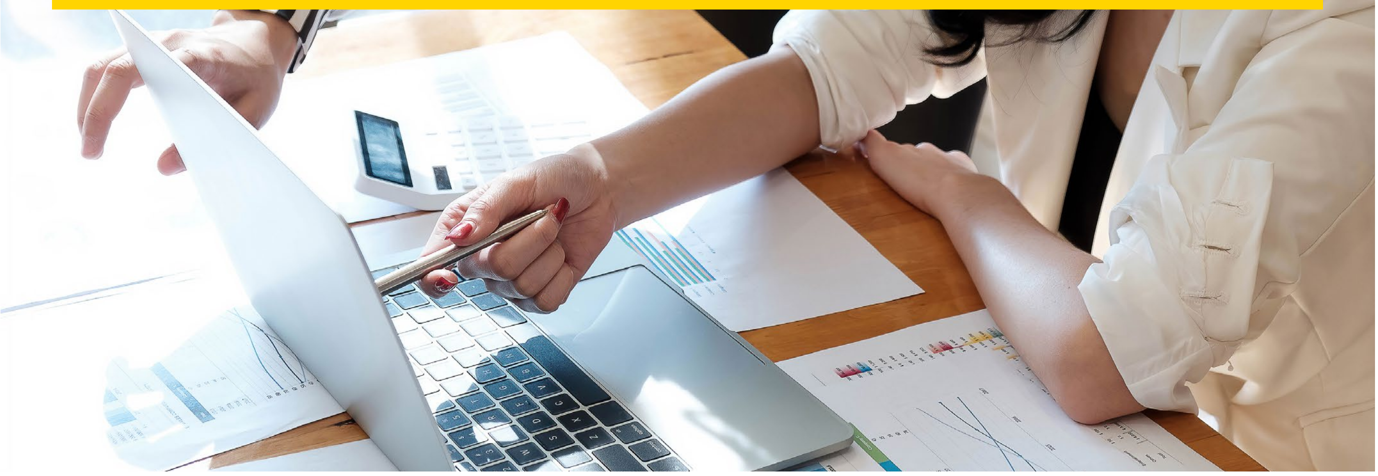
Following are the key elements for a KFS:

- KFS to be provided in simple language before execution of loan contract and as per format provided in the circular which is easy to understand.
- Contents of KFS shall be explained to the borrower and an acknowledgement shall be obtained that they have understood the same.
- The KFS to be assigned a unique proposal number and shall remain valid for:
  - three working days for loans with a tenor of seven days or more,
  - one working day for loans with a tenor of less than seven days.
- The standardised format of KFS included in annexure A of the circular mandates including the Annual Percentage Rate (APR), which represents the total cost of the loan, including interest rates and all associated fees. The KFS to include an amortization schedule and a detailed breakdown of the APR calculation.
- Fees not mentioned in KFS cannot be charged to borrower without borrower's consent.
- KFS shall also be included as a summary box to be exhibited as part of the loan agreement.

The guidelines to be implemented for all new retail and Micro, Small & Medium Enterprises (MSME) term loans (including fresh loans to existing customers) sanctioned on and after 01 October 2024. Credit card receivables are exempted from the provisions contained under this circular.

How we see it

The RBI's initiative to implement a standardized KFS for Loans & Advances across all REs reflects its commitment to enhancing the transparency, comparability and fairness of the financial system, thereby protecting the interests of borrowers, and promoting responsible lending practices.



5. Master Direction on Treatment of Wilful Defaulters and Large Defaulters

Circular Date: 30 July 2024

Effective Date: 28 October 2024

Applicability: Regulated Entities (REs):

- All Commercial Banks including SFBs, Local Area Banks and RRBs and excluding Payments Banks
- All Primary UCBs / StCBs / Central Co-operative Banks
- All India Financial Institutions [Exim Bank, National Bank for Agriculture and Rural Development (NABARD), NHB, Small Industries Development Bank of India (SIDBI) and National Bank for Financing Infrastructure and Development (NaBFID)]
- All NBFC [Middle Layer (ML) and above as per SBR, 2021] including HFCs
- All Asset Reconstruction Companies (ARCs)
- All Credit Information Companies (CICs)

The RBI has issued Master Directions on the Treatment of Wilful Defaulters and Large Defaulters, outlining detailed guidelines on the procedures for classifying and handling borrowers under these categories. The direction aims to regulate the credit system by communicating credit information about wilful defaulters.

As stated in the directions, **"wilful defaulter"** means a borrower or a guarantor who has committed wilful default and the outstanding amount is INR25 lakh and above, or as may be notified by RBI from time to time. "Large defaulter" means a defaulter with an outstanding amount of INR1 crore and above, and where suit has been filed; or whose account has been classified as doubtful or loss.

Brief procedure for classification

A lender may classify a person as a wilful defaulter by following the prescribed procedure, ensuring the default is intentional, deliberate, calculated and meets specific criteria:

- If the Identification Committee (IC) concludes wilful default, a show-cause notice (SCN) is sent to relevant identified parties (for example, borrower, guarantor, or management) within 21 days. The notice has to include all materials information forming the basis of SCN.
- Once the IC is satisfied with the response of the SCN, they shall make a proposal in writing to the Review Committee for classification of relevant identified party as a wilful defaulter.
- An opportunity shall be provided to the relevant identified party for making a written representation to the Review Committee within 15 days of such a proposal.
- After assessing the facts and representation and providing an opportunity to be heard, the Review Committee shall pass a reasoned order for such classification.

Review of accounts for identification of wilful default

Lenders to review all non-performing assets (NPAs) with outstanding amounts of INR25 lakh and above for wilful default. If identified during preliminary screening, the borrower may be classified as a wilful defaulter, by performing above procedure, within six months of the NPA classification.

Measures to be taken against wilful defaulters

- Lenders may initiate criminal proceedings against wilful defaulters if deemed appropriate. Even if a wilful defaulter's name is removed from the List of Wilful Defaulters (LWD), criminal proceedings, once initiated, will continue unaffected.
- The lenders shall formulate a Board-approved policy to set out the criteria for publication of photographs of persons classified and declared as wilful defaulters.
- Lenders to implement the following penalties for wilful defaulters:
    - No additional credit facilities will be granted to wilful defaulters or their associated entities.
    - This restriction continues for one year after their removal from the LWD as per lender.
    - No credit facility is given for new ventures of wilful defaulters or their associated entities for five years after removal from the LWD as per lender.
    - Wilful defaulters and associated entities cannot access credit restructuring until their removal from the LWD, after which restructuring is allowed, subject to, no additional credit facilities as mentioned above.

- Lenders to include a clause in credit agreements, prohibiting borrowers from appointing individuals listed in the LWD to their Board or management.
- If such an individual is found on the Board, the borrower to ensure their immediate removal.
- If a lender makes a claim against a guarantor due to a default by the principal debtor, then the guarantor's liability becomes immediately enforceable. If the guarantor fails to meet this demand, they shall be considered for classification as a wilful defaulter.

Supervision of wilful defaulters

- The lender shall require their internal auditors to specifically look into adherence to instructions for classifying a borrower as a wilful defaulter.
- The Audit Committee of the lender shall periodically review the cases of wilful default and recommend steps to be taken to prevent such occurrences and their early detection to these occurences. The review shall focus on identifying root causes of wilful default and addressing deficiencies.

Reporting and dissemination of credit information

- Lenders are required to submit information monthly, as per the format mentioned in the circular, to CICs regarding suit-filed accounts of large defaulters and non-suit filed accounts classified as doubtful or loss.
- Lenders or ARCs are required to submit a monthly LWD, as per the format mentioned in the circular, to CICs, covering both suit-filed and non-suit filed accounts.

Related to Statutory Auditors

- If the auditors are found to be negligent or deficient in conducting the audit, for falsification of borrower accounts, and the same is observed by the lender, then the lender can lodge a formal complaint against the statutory auditors of the borrowers with the National Financial Reporting Authority (NFRA) / The Institute of Chartered Accountants of India (ICAI).
- Pending disciplinary action by NFRA/ ICAI, the complaints shall be forwarded to the RBI (Department of Supervision, Central Office) and Indian Banks' Association (IBA).
- With a view to monitor the end-use of funds, appropriate covenants are be incorporated in the loan agreements. If the lender requires specific certification from the borrower's auditors regarding diversion or siphoning of funds, it should be explicitly stated.

Other provisions

- Name of the wilful defaulter shall not be removed from LWD unless it pays whole compromise amount as per the compromise agreement or the amount is not less than INR25 lakh or as notified by the RBI from time to time, in other cases.
- The lender to internally conduct a comprehensive investigation from a wilful default perspective before selling a defaulted loan, with outstanding of INR25 lakh and above, whether it is NPA or not, to other parties.
- The REs of the RBI shall monitor the end-use of funds and obtain certificates from borrowers certifying that the funds have been utilised for the purpose for which they were obtained, and these measures shall form part of their loan policy document. In case of the wrong certification by the borrowers, the REs shall consider initiating appropriate legal proceedings.

How we see it

The 2024 Master Directions from RBI mandate lenders to establish Board-approved policies that ensure a just and clear-cut process for identifying wilful defaults. This includes specifying the officials responsible for issuing SCN and orders to borrowers/guarantors, setting the timetable for re-examining accounts to detect wilful defaults, and for identifying the criteria for publishing the photographs of persons identified as wilful defaulters. Lenders are also instructed to have their audit committees and internal auditors periodically review such accounts and to maintain vigilant monitoring of the end-use of disbursed funds until loans are repaid.

The role of ARCs and CICs has been largely limited to routine reporting on wilful and significant defaulters. However, all RBI-regulated entities, including NBFCs, ARCs, and CICs, are now obliged to adhere to the penal consequences outlined for wilful and large defaulters as per the 2024 Master Directions.

Consequently, all RBI-REs to ensure that they have comprehensive Board policies for the proper execution of their responsibilities, delegating the necessary authority to their officers, and fostering an understanding of the current legal precedents concerning the classification of wilful defaulters. REs to ensure that they establish a transparent system for identifying wilful defaults that aligns with the guidelines set forth by the regulator.

6. Guidance Note on Operational Risk Management and Operational Resilience

Circular Date: 30 April 2024

Effective Date: 30 April 2024

Applicability: Regulated Entities (REs):

- All Commercial Banks
- All Primary UCBs/ StCBs /Central Co-operative Banks
- All-India Financial Institutions (viz., Exim Bank, NABARD, NHB, SIDBI, and NaBFID); and
- All NBFCs including HFCs.

The growing importance of NBFCs in India's financial landscape and their increasing interconnectedness with the broader financial system, has led to heightened regulatory scrutiny from the RBI.

The RBI released an updated Guidance Note on Operational Risk Management and Operational Resilience, which repeals the Guidance Note on Management of Operational Risk dated 14 October 2005.

The updated guideline introduces the Basel Committee on Banking Supervision (BCBS) Principles and international best practices in line with RBI rules. It provides the requirements that NBFCs need to adhere to give assurance on robust risk management practice implemented in their organisation. It includes a comprehensive framework for managing operational risk, urging NBFCs to adopt specific risk management measures. It aims to integrate Operational Risk Management Function (ORMF) into an NBFC's existing risk governance framework, which would enhance their ability to withstand, adapt and recover from potential operational disruptions and ensure operational resilience.

This Guidance Note has been built on three pillars:

- Prepare and Protect
- Build Resilience
- Learn and Adapt

Across these three pillars, the Guidance Note contains 17 principles, as follows:

- **Governance and risk culture-** The Board along with Senior Management to establish a robust risk management culture, emphasizing ethics, oversight, clear roles, aligned incentives, and comprehensive training.
  - REs may standardize operational risk management by enhancing governance, understanding risks in new ventures, integrating ORMF across lines of defence (LOD), and ensuring Senior Management accountability with Board oversight.
- **Responsibilities of Board and Senior Management-** The Board to cultivate a risk management culture, oversee operational risk processes, ensure effective ORMF implementation, and regularly review resilience approaches with clear directives and accountability.
  - The RE to establish a Board-approved risk appetite and tolerance statement, define critical operations and impact tolerances, and review these annually or upon significant business changes.
  - The principle emphasizes a well-documented ORMF led by Senior Management, and includes clear policies, responsibilities, resource allocation, strong challenge mechanisms, effective communication, skilled hiring, and a specialized committee for oversight and expertise in various domains.
- **Risk management environment identification and assessment:** To employ risk identification and assessment tools aligned with ORMF, highlight process-level risks and controls, ensure data accuracy, and conduct regular assessments to inform Senior Management and optimize resource allocation.
- **Change management-** Have an effective change management process to establish clear policies and procedures, assign responsibilities across LOD, document risk assessments, and implement review, approval, and monitoring mechanisms to manage evolving risks throughout the change lifecycle.
- **Monitoring and reporting-** To implement a strong reporting mechanism with defined metrics, regular frequency, clear ownership, and recipient roles, ensuring timely information flow to Senior Management and the Board for effective oversight and course correction.
- **Control and mitigation-** To establish a robust internal controls system, documented in policy, to ensure operational efficiency, asset protection, reliable reporting, and compliance, while managing technology risks, third-party dependencies, and considering risk transfer options, with ongoing monitoring and central record-keeping.

- **Mapping interconnections and interdependencies-** To identify critical operations, map necessary interconnections, document essential components, extend mapping to all functions for comprehensive coverage, and account for group-level risks to ensure preparedness for disruptions in line with their operational resilience strategy.
- **Third-party dependency management-** Manage third-party dependencies by conducting risk assessments, performing ongoing reviews, documenting vendor policies, establishing robust contracts, and developing continuity plans for resilience against third-party disruptions.
- **Business continuity planning and testing-** Effective governance of business continuity in REs requires Board oversight, Senior Management involvement, comprehensive plans with scenario analyses, critical operation coverage, and detailed disaster recovery guidance with clear roles and triggers.
- **Incident management-** Ensure operational robustness by maintaining incident response and recovery resources, documenting comprehensive management plans, establishing clear communication strategies, and regularly reviewing and updating procedures.
- **Information and Communication Technology (ICT) including cybersecurity-** Ensure robust ICT risk management by documenting policies, aligning strategies with risk appetite, conducting regular reviews, preparing for disruptions, and prioritizing cybersecurity in compliance with data protection laws.
- **Disclosure and reporting-** Provide clear public disclosures on operational risk approach and ORMF effectiveness, tailored to size and complexity of the entity, without increasing risk through over-disclosure, and maintain a formal, regularly reviewed disclosure policy.
- **Lessons learned exercise and adapting-** Conduct root cause analyses, maintain incident repositories, identify patterns, establish accountability, and continuously update risk management practices based on lessons learned to enhance operational resilience.
- **Continuous improvement through feedback system-** Foster a culture of learning and continuous improvement in operational resilience by demonstrating leadership commitment, establishing robust feedback systems, assessing risk impact, and periodically updating mechanisms.

These principles are segregated in five categories:

01 **Governance and strategy**

- Policies - operational risk management, third party risk management, operational resilience, technology and conduct risk
- Board and senior management accountability
- Risk management committees
- Risk appetite and tolerance

02 **Identify, evaluate, measure and monitor risk**

- Risk and control self-assessment
- New product assessments
- Key risk indicators
- Incident management
- Control monitoring and assurance
- Scenario analysis and stress testing

03 **Operational resilience**

- Business critical operations
- Map interconnections and interdependencies
- Perform data centre and disaster recovery drill testing to ensure effective uptime and support

04 **Information and communication technology including cyber security**

- Information and communication technology readiness for stressed scenarios
- Incident management (IT and cyber) and response processes
- Integrity of critical information during cybersecurity events.

05 **Managing third-party dependency**

- Third party risk assessment and due diligence
- Business continuity plan and procedures for resilience during disruptions
- Supply chain complexity and Nth party risks

How we see it

So far, the regulator's focus was primarily on banks. However, the regulator is now extending the emphasis on operational risk excellence for NBFCs. It is imperative for Senior Management to conduct a thorough evaluation of the current operational risk framework. Additionally, Management to develop a comprehensive policy and framework for Operational Risk Management that aligns with the recently issued Guidance Note on Operational Risk Management and Operational Resilience.

7. Master Directions on Fraud Risk Management

Circular Date: 15 July 2024

Effective Date: 15 July 2024

Applicability: Regulated Entities (REs)

- Banks
  - Commercial Banks (including RRBs) and All India financial institutions (revised Master Directions-Banks)
  - UCBs / StCBs / Central Cooperative Banks (CCBs)
- NBFCs (including HFCs)

The RBI has issued updated Master Directions on Fraud Risk Management (FRM) for REs on 15 July 2024 to enhance the mechanisms for managing and mitigating fraud risks within REs. These directions supersede the earlier directions – RBI [Frauds - Classification and Reporting by commercial banks and select financial institutions (FIs)]. The revised Master Directions emphasize a principles-based approach, highlighting the critical role of the Board in governing and supervising the management of fraud risks in REs. They provide a structured approach for preventing fraud, detecting it early, and ensuring prompt reporting to appropriate regulatory authorities.

Key guidelines as provided by the RBI are:

Strengthening governance and oversight

- **Enhanced responsibility (for Banks / NBFCs)**
  - There shall be a Board-approved policy on FRM, delineating roles and responsibilities of Board/ Board Committees and Senior Management.
  - The policy should comply with natural justice principles, including issuing detailed SCNs and providing a minimum of 21 days for responses.
  - Detailed SCNs to be issued to individuals or entities accused of fraud, providing transaction details.
  - Responses for SCNs to be examined before declaring fraud, and a reasoned order to be issued.
  - Board to review the FRM policy at least once every three years or more frequently if needed.
- **Special Committee of Board for Monitoring and Follow-up of Frauds (SCMBF) (for Banks / NBFCs)**
  Establishing Fraud Monitoring Committees ensures focused attention on fraud prevention and management. Following are the responsibilities / points for SCMBF:
  - A Special Committee for Monitoring and Follow-up of Fraud Cases (SCBMF) is to be established, consisting of the Chief Executive Officer (CEO) and two directors.
  - The SCBMF is to oversee FRM effectiveness, review fraud cases, and suggest measures to strengthen internal controls.
  - Senior Management is responsible for implementing the FRM policy and periodically reviewing fraud incidents with the Board or Audit Committee.
  - A transparent mechanism to be in place for overseeing whistle blower complaints regarding possible fraud or suspicious activities.
  - An appropriate structure for FRM to be established within the entities overall risk management functions, with a senior official responsible for monitoring and reporting frauds.
  - Applicable NBFCs shall disclose the amount related to fraud reported in the company for the year in their Financial Statements – Notes to Accounts and assess impact of balances reported in previous year/ restatement of financial statements, etc.

Improving fraud detection and reporting

Early Warning Systems (EWS): Implementing systems to detect early signs of fraud helps in timely intervention and mitigation.

- For Commercial Banks:
  - A system of robust EWS that is integrated with:
    - Core Banking Solution (CBS) or other operational systems.
    - Initiation of remedial action on alerts / triggers from EWS in a timely manner.
    - Periodic review of credit sanction and monitoring processes, internal controls, and systems; and
    - Effective use of Central Repository of Information on Large Credits (CRILC) database and the Central Fraud Registry (CFR).

- The EWS to be comprehensive and designed to include both the quantitative and qualitative indicators to make the framework robust and effective. The broad indicators, which the EWS may illustratively capture, could be based on the transactional data of accounts, financial performance of borrowers, market intelligence, conduct of the borrowers, etc.
- Banks to establish a dedicated Data Analytics and Market Intelligence (MI) Unit keeping in view their size, complexity, business mix, risk profile, etc. Such a unit may facilitate collection and processing of relevant information to enable early detection and prevention of potentially fraudulent activities.
- Generation of EWS alert / trigger to necessitate examination whether the account needs to be red flagged and consequently, investigation from potential fraud angle.

- For Cooperative Banks:
  - The EWS framework to be part of overall FRM Policy approved by the Board, it is applicable to UCBs (Tier 3 and 4) and StCBs/CCBs with deposits above INR1,000 crore.
  - A Board Level Committee to oversee the EWS framework's effectiveness, and Senior Management will be responsible for implementing the EWS framework.
  - EWS to be integrated with CBS or other systems. Timely remedial actions to be initiated based on EWS alerts.
  - Banks to implement or upgrade their EWS within six months from the issuance of these directions.
- For NBFCs:
  - NBFCs (including HFCs) in the ML and UL are required to establish a framework for EWS as part of their overall FRM policy.
  - The EWS framework to address key aspects, including the integration of the EWS with the CBS.
  - The EWS indicators for both credit and non-credit facilities may be approved by the Board-level Committee (BLC).
  - NBFCs to implement or upgrade their EWS system within six months from the issuance of these directions.

Indicative list of early warning signals

- Delay observed in payment of outstanding dues.
- Frequent change in the scope of the project to be undertaken by the borrower.
- Default in undisputed payment to the statutory bodies as declared in the Annual Report.
- Concealment of certain vital documents such as master agreement, insurance coverage.
- Non-production of original bills for verification upon request.
- Heavy cash withdrawal in loan accounts.
- Floating front/associate companies by investing borrowed money.

Credit facility/ loan account classified as Red-flagged Account and Reporting of Fraud (for Banks)

- In case of a credit facility / loan account classified as red-flagged account (RFA), banks to use an external audit or an internal audit as per their Board-approved policy, for further investigation in such accounts.
- The decision to classify any account, either standard or NPA, as RFA to be at the individual bank level and such bank to report the status of the account on the RBI's CRILC platform immediately (not later than seven days from date of classification as RFA).
- Once an account has been red-flagged, the entire classification process - either confirming it as fraud or removing as red-flagged status is to be completed within 180 days from the initial reporting date on the CRILC platform. 180-days timelines reporting to the SCBMF for review is to be accompanied with adequate reasoning / justification. Such cases shall be subject to supervisory review by the RBI.
- In case an account is identified as a fraud by any bank, the borrower accounts of other group companies, in which one or more promoter / whole-time director are common, shall be subject to examination by banks concerned from fraud angle under these directions.

NBFCs are not required to classify accounts as RFA, instead they have to remain alert on activities which could potentially turn out to be fraudulent. Where there is a suspicion of a fraud or any wrongdoing, the NBFC (including HFC) to further investigate into that account with the help of an external auditor or an internal auditor.

Independent confirmation from the third-party service providers including professionals (for Banks)

- Banks rely on various third-party service providers as part of pre-sanction appraisal and post-sanction monitoring. Therefore, banks may incorporate necessary terms and conditions in their agreements with third-party service providers to hold them accountable in situations where wilful negligence / malpractice by them is found to be a causative factor for fraud.
- Banks shall, after complying with the principles of natural justice, report to IBA the details of such third parties or professionals involved in frauds. IBA would, in turn, prepare caution lists of such third parties for circulation among the banks.

Applicable NBFCs rely on various third-party service providers as part of pre-sanction appraisal and post-sanction monitoring. Therefore, applicable NBFCs may incorporate necessary terms and conditions in their agreements with third-party service providers to hold them accountable in situations where wilful negligence / malpractice by them is found to be a causative factor for fraud.

Reporting framework (for Banks/ NBFCs)

Fraud incidents are to be reported promptly to the RBI, law enforcement agencies, and, where applicable, NABARD. A centralized database of fraud incidents is maintained to facilitate information sharing across banks and mitigate risks. Ensuring that fraud incidents are reported promptly to the RBI and law enforcement agencies facilitates swift action and resolution.

Banks to establish nodal points or designate officers responsible for reporting frauds and coordinating with the regulators. Fraud investigations are to be completed before transferring loan accounts to other lenders/ARCs. If a fraud has been perpetrated in the account, then it shall be reported to NABARD/RBI.

Applicable NBFCs to disclose the amount related to fraud reported in the company for the year in their Financial Statements – Notes to Accounts.

Staff accountability (for Banks / NBFCs)

Staff accountability in fraud cases are to be examined promptly. The Audit Committee of the Board (ACB) to review senior executives' accountability. Banks are mandated to identify and address any staff complicity or negligence in fraud cases. Persons/ Entities classified and reported as fraud by banks and also entities and persons associated with such entities, shall be debarred from raising of funds and/ or seeking additional credit facilities from financial entities regulated by RBI, for a period of five years from the date of full repayment of the defrauded amount/ settlement amount agreed upon in case of a compromise settlement.

Treatment of accounts under Resolution (for Banks/ NBFCs)

Borrowers classified as fraud accounts may undergo resolution either under the IBC or an RBI resolution framework, potentially leading to a change in the management and control of the business. Such borrowers are to be examined by the REs to determine whether they continue to be classified as 'fraud accounts.'

Penal measures will not be applicable to such borrowers once the resolution plan is implemented. However, criminal proceedings and penal measures would continue against the erstwhile promoters/directors.

Other key matters (for Banks/ NBFCs)

- **Legal audit of title documents in respect of large value loan accounts:** The title deeds and other related title documents in respect of the credit facilities of INR5 crore and above will be subject to periodic legal audit and re-verification, scope of which to be Board-approved.
- **Auditor's role:** Where transactions or documents point to the possibility of fraudulent transactions, auditor to immediately bring it to the notice of the Senior Management and audit committee.
- **'Date of Occurrence', 'Date of Detection' and 'Date of Classification' of fraud:** The RBI has prescribed definitions of the following terms, which are used in FMR:
  - The **'date of occurrence'** is the date when the actual misappropriation of funds has started taking place, or the event occurred, as evidenced/reported in the audit or other findings.
  - The **'date of detection'** to be reported in Fraud Monitoring Return (FMR) is the actual date when the fraud came to light in the concerned branch / audit / department, as the case may be, and not the date of approval by the competent authority of the bank.
  - The **'date of classification'** is the date when due approval from the competent authority has been obtained for such classification, and the reasoned order is passed.
- **Reporting cases of theft, burglary, dacoity and robbery:** Instances of theft, burglary, dacoity, and robbery (including attempted cases) to be reported to the Fraud Monitoring Group (FMG), Department of Supervision, Central Office, and the RBI within seven days of their occurrence. A quarterly return (RBR) reporting theft, burglary, dacoity, and robbery to be submitted to the RBI via the online portal, covering all incidents that occurred during the quarter. This is to be filed within 15 days after the end of the respective quarter. HFCs to report such incidents to NHB in the manner and returns/formats as prescribed by NHB.

How we see it

The revised Master Directions is a significant step in enhancing the robustness of fraud prevention and control measures within India's financial sector. By emphasizing the principles of natural justice, the new guidelines ensure that the rights of all stakeholders are protected while maintaining the integrity of the financial system. The detailed requirements for reporting, audit, and compliance provide a clear framework for regulated entities to follow, promoting transparency and accountability.

REs may further face challenges to abide by the Directions such as increased compliance burdens, operational costs, legal risks, and staff accountability concerns under the RBI's revised Fraud Risk Management guidelines. To mitigate these, companies may invest in AI-driven fraud detection, employee training, clear reporting frameworks, and crisis management plans to enhance compliance and minimize financial and reputational risks.

8. Regulatory Principles for Management of Model Risks in Credit

Draft Circular Date: 05 August 2024

Effective Date: In phased manner as described below.

Applicability:

- All Commercial Banks (including RRBs and Local Area Banks)
- All primary UCBs
- All StCBs and Central Cooperative Banks
- All NBFCs (including HFCs)
- All-India Financial Institutions

The RBI issued a draft circular for Regulatory Principles for Management of Model Risks in Credit, which provides a detailed guideline on model risk management framework, implying the need for a comprehensive understanding, a robust validation mechanism and appropriate governance and oversight.

'Credit risk model' refers to any quantitative method that applies statistical, economic, financial, or mathematical principles and assumptions to process data into an output to be used for credit decisions.

Governance and oversight

REs are required to establish a detailed Board-approved policy with regard to model risk management framework for all models deployed, covering the entire model life cycle. The policy shall cover, inter alia:

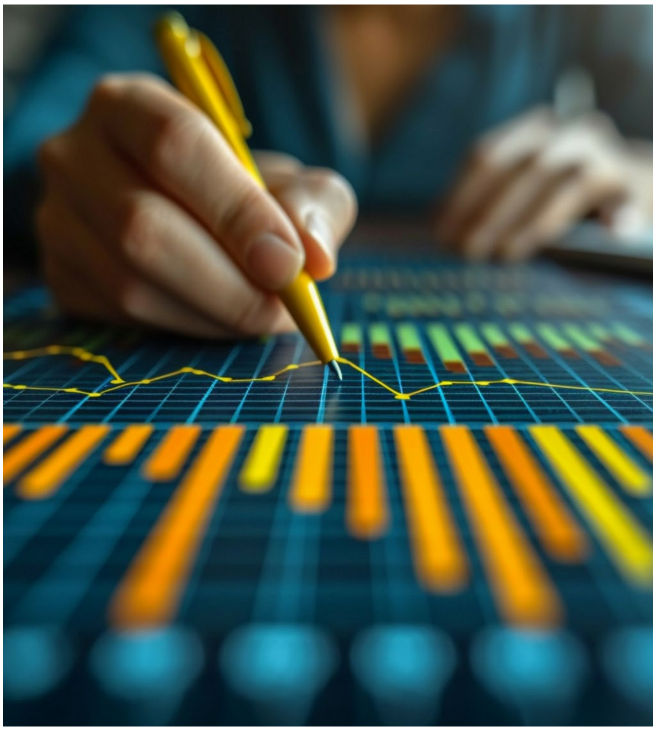
- Detail of model materiality
- Processes for development or selection
- Documentation for models deployed
- Review processes
- Monitoring and reporting framework

The REs shall maintain a model inventory of approved models, insourced or outsourced, with critical information on it. Any subsequent changes in their inputs or assumptions, shall be approved by the Risk Management Committee of the Board (RMCB) or any other sub-committee, as designated by the Board.

Model development and deployment principles

The models that the REs use may either be developed internally or sourced from external third-party suppliers, minimum technical documentation on the models to be provided to REs in such case, subject to the following broad principles:

- The objectives of the model, problem statements and solution sought from the model are to be clearly defined.
- The inputs and assumptions considered to ensure effective address of the intended objectives of the model on a consistent basis.
- There shall be detailed documentation for each of the models, and which is to include sensitivity of the outputs, assumptions, and inputs, to facilitate clear understanding.
- The models to include necessary scalability and flexibility, to meet the needs of dynamic business conditions.
- The model shall have the necessary interface with core banking/financial system, liquidity management, asset liability management or any other risk management system of the RE.
- Outcomes of the model to be consistent, unbiased, explainable, and verifiable.
- In case subjective factors are used to override model outcomes, then the same shall be as per the provisions of the policy and such deviations shall be suitably documented in an auditable format



Model validation framework

- **Independent validation:** REs to have an independent model vetting/validation process separate from model development, conducted before deployment, after material changes, or annually. External experts may be engaged for validation as per policy. Validation includes reviewing assumptions, data accuracy, regulatory compliance, documentation completeness, and model outcomes through back-testing. It also identifies limitations, biases, or discrimination for corrective measures.
- **Reporting outcomes:** Validation results to use clear, predefined parameters, benchmarked against policy standards, and reported to the Risk Management Committee (RMC) or a designated sub-committee of the Board. Outcomes of the model shall be consistent, unbiased, explainable, and verifiable.
- **Supervisory review:** The RBI may review models through supervisory evaluations or external experts. For external models, REs to include contractual clauses enabling such evaluations.

The circular mandates that new credit models comply with the guidelines starting from 05 November 2024, while existing models to be validated according to these guidelines by 05 February 2025, following their issuance on 05 August 2024.

How we see it

This RBI circular will help to establish a robust regulatory framework for managing model risks in credit processes, which plays a very crucial role in financial institutions. This step reflects the growing reliance of financial institutions or banks on advanced models for credit decision-making, risk analysis, and compliance. Thus, the framework will help in effective and consistent model development and regulation. Given technological advancements have led to more complex models, there is a heightened need for enhanced validation processes.

REs are encouraged to implement a coherent, transparent, and auditable methodology for utilization models, thereby bolstering confidence within the financial ecosystem. Moreover, REs to establish a strong governance framework, articulate clear policies and procedures, and maintain a vigorous oversight system to adeptly manage model risk. This approach also necessitates a comprehensive understanding among all stakeholders—including the Board, management, and external collaborators—of their respective duties and accountabilities within the model risk management framework. This RBI circular aims to create a strong regulatory framework for managing model risks in credit processes, crucial for financial institutions. It reflects the growing use of advanced models in credit decisions, risk analysis, and compliance, ensuring effective model development and regulation. With the rise of complex models, there is an increased need for improved validation processes.

This RBI circular shall impact how financial institutions calculate Expected Credit Loss (ECL) under Indian Accounting Standards (Ind AS), which has brought significant changes to the provisioning requirements for credit losses.

- Key principles outlined in the circular for model development and deployment include the requirement for comprehensive documentation of models, covering the sensitivity of outputs, assumptions, and inputs. This documentation should enable a clear understanding of the models. Additionally, the models must be scalable and flexible enough to adapt to changing business conditions. The models should also interface effectively with core banking/financial systems, liquidity management, asset-liability management (ALM), and other risk management systems. When determining ECL, institutions (REs) must ensure compliance with these guidelines. Given the complexity of ECL computations, which rely on historical, current, and forward-looking data REs may need to reassess their current ECL calculation processes.
- The principles further emphasize the need for a robust model validation framework, where the model's outcomes should be reported to the Risk Management Committee (RMC) and/or relevant sub-committees. The RBI may also review models through supervisory evaluations or external experts. REs are required to establish strong governance, clear policies, and effective oversight mechanisms to manage model risk. It is crucial that all stakeholders, including the Board, management, and external collaborators, fully understand their roles and responsibilities in managing model risk.

9. Master Direction – Reserve Bank of India (Asset Reconstruction Companies) Directions, 2024

Circular date: 24 April 2024

Effective date: 24 April 2024 (Updated on 21 January 2025)

Applicability: All Asset Reconstruction Companies (ARC)

Registrations and related matters

- Registration requirements
  - Certificate of Registration (CoR): ARCs to obtain a mandatory CoR from the RBI to engage in securitization or asset reconstruction activities.
  - Commencement of business: ARCs to start operations within six months from the CoR issuance date. The RBI may grant a twelve -month extension in exceptional cases.
- Financial prerequisites
  - Net Owned Fund (NOF): ARCs are required to have a minimum NOF of INR300 crore to begin and sustain business operations. Failure to comply may result in the RBI imposing supervisory actions, including a prohibition on business activities.
  - ARCs existing as on 11 October 2022 to follow the below mentioned glide path to achieve the minimum required NOF of INR300 crore:

Minimum required NOF on 11 October 2022	by 31 March 2024	by 31 March 2026
INR100 crore	INR200 crore	INR300 crore

- Permitted activities
  - Legislative compliance: ARCs to operate within the scope of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, and other relevant laws, such as the Insolvency and Bankruptcy Code (IBC), 2016, subject to specific conditions.
  - Investment and sponsorship: ARCs are allowed to act as sponsors and invest in the equity share capital of other ARCs for establishing joint ventures.
  - Fund deployment: ARCs may allocate funds to reorganize the financial structure of acquired loans, aiming to facilitate the recovery of outstanding amounts.
  - Investment of surplus funds: Surplus monies may be invested in government securities, Scheduled Banks, and money market mutual funds, etc.
- Restricted activities
  - Investment in land and building:

    No ARCs shall invest in land and building except:

    - Investment in land and building for its own use up to 10% of its owned funds.
    - Any land or building acquired by the ARC in satisfaction of claims during the ordinary course of business which are required to be disposed of within five years from the date of acquisition, unless an extended period is granted by the RBI.
  - Raise monies through deposits: No ARCs shall raise monies by way of deposits.

Guidelines on Asset Reconstruction and Securitisation

- Board-approved policies:
  - Develop a 'financial asset acquisition policy' within 90 days post-CoR.
  - Ensure transactions are transparent and at fair price in a well-informed market.
  - Outline procedures for asset acquisition, types of assets, and valuation methods.
  - Include both fund and non-fund-based assets, and Special Mentioned Accounts (SMAs) for acquisition.
  - Standardize valuation for similar asset profiles, conducted internally or via independent agencies.
- Acquisition from banks/ financial institutions:
  - Calculate the share of financial assets to be acquired.
  - Obtain approval from secured creditors holding not less than 60% of the amount outstanding to a borrower for the purpose of enforcement of security interest.
  - Board approval required for policy deviations.
  - Prohibit bilateral acquisitions from specified entities.

- Plan for realisation of financial assets
  - Formulate a policy with a maximum realization period of five years, extendable to eight years by the board.
  - Measures of asset reconstruction.
  - Change in or takeover of the management of the business of the borrower - ARCs may take over a borrower's business management if there is a payment default and unpaid dues, following Section 15 of the Act. After full debt recovery, management is returned to the borrower. This process requires an Independent Advisory Committee (IAC) review and a Board-approved policy. A sixty-day notice to the borrower is mandatory. Grounds for effecting change in or takeover of management are as follows:
    - Defaults in repayment of the amount due in following circumstances:
      - Non-payment of dues despite adequate cash flow and availability of other resources.
      - Routing of transactions through banks which are not lenders/ consortium members to avoid payment of dues.
      - Siphoning off funds or misrepresentation/ falsification of records.
    - Management of the borrower's business is acting in a manner adversely affecting the interest of the creditors (including ARC) or failing to take necessary action to avoid any such event.
    - Management of the borrower's business is not competent to run the business or the key managerial personnel of the business of the borrower have not been appointed for more than one year from the date of such vacancy.
    - Borrower has without the prior approval of the secured creditors (including ARCs), sold, disposed of, charged, encumbered or alienated 10% or more (in aggregate) of its assets secured to the ARC.
    - There are reasonable grounds to believe that the borrower would be unable to pay its debts as per the accepted terms.
    - The borrower has entered any arrangement or compromise with creditors without the consent of the ARC which adversely affects the interest of ARC.
    - The borrower discontinues or threatens to discontinue any of its businesses constituting 10% or more of its turnover.
    - All or a significant part of the assets essential for its business are damaged due to the actions of the borrower.
    - In case of following instances, which materially affect the ability of the borrower to repay the loan:
      - The general nature or scope of the business, operations, management, control or ownership of the business of the borrower are altered to an extent.
      - Serious dispute/s have arisen among the promoters or directors or partners of the business of the borrower.
      - Misutilization of the funds borrowed or disposal of the financed assets and misuse or misappropriation of the proceeds.
    - Fraudulent transactions by the borrower in respect of the assets secured to the creditor/s.

Rescheduling of debts payable by the borrower - ARCs are required to establish a Board-approved policy for rescheduling borrower debts, ensuring that it aligns with an acceptable business plan, projected earnings, and cash flows, and does not adversely affect their asset liability management or investor commitments.

Enforcement of security interest - ARCs to obtain approval of secured creditors, who hold at least 60% of the outstanding amount owed by a borrower, to enforce security interest.

Settlement of dues payable by the borrower[1]

- ARCs to have a Board-approved policy for settling borrower dues, including criteria for one-time settlements, permissible sacrifice for various exposures, and methods for evaluating security values
- The Net Present Value (NPV) of the settlement amount should generally be not less than the realizable value of securities. If there is a significant variation between valuation of the securities recorded at the time of acquisition and realisable value of the securities assessed at the time of entering a settlement, reasons thereof shall be duly recorded.
- Payment terms- Lump sum payment and instalment payments.
  - INR1 crore or below - An independent review is required, and quarterly reports are submitted to the Board or a Committee.
  - Over INR1 crore - Review by IAC, considering the borrower's financial status, recovery timeframe, projected cash flows, and other relevant factors. For wilful defaulters, these guidelines shall be applicable, irrespective of the amount involved.

[1] *vide Circular no. DoR.SIG.FIN.REC.56/ 26.03.001/2024-25 dated January 20, 2025*

Conversion of any portion of debt into equity of a borrower entity - ARCs to create a Board-approved policy for debt-to-equity conversion in borrower entities, with the ARC's post-conversion shareholding capped at 26% of the entity's equity, subject to certain exceptions.

Securitisation - Before issuing Security Receipts (SRs), ARCs to create a Board-approved policy and transfer assets to trusts at the original acquisition price unless directly acquired by the trust. ARCs are required to invest a minimum of 15% of the transferor's investment or 2.5% of the total SRs issued, and value SRs for Net Asset Value (NAV) based on a recovery scale with percentages reflecting the ARC's recovery experience, justifying their chosen percentage.

Illustration: If the range of recovery is between 81% and 90%, ARC may pick up 87% based on its judgement. If the face value of SR is INR10, the face value will be multiplied by the recovery percentage, i.e., 87%, to arrive at the NAV as INR8.70.

Prudential regulations

Capital Adequacy Ratio (CAR) - ARCs are required to maintain a minimum CAR of 15% of their total risk-weighted assets continuously. For this calculation, 'capital' is defined as the NOF, and the risk-weighted assets include both on-balance sheet and off-balance sheet items.

- Asset classification
  - ARC to classify assets considering the credit weaknesses and reliance on collateral for recovery, to Standard Assets and NPA (non-performing assets).
  - NPA shall be classified further as:
    - **'Sub-standard asset':** Period not exceeding 12 months from the date it was classified as NPA.
    - **'Doubtful asset':** A sub-standard asset for a period exceeding 12 months.
    - **'Loss Asset' if:**
      - the asset is NPA for a period exceeding 36 months.
      - the asset is adversely affected by a potential threat of non-recoverability due to either erosion in the value of security or non-availability of security.
      - the asset has been identified as a loss asset by the ARC or its internal or external auditor.
  - Assets acquired by the ARC for the purpose of asset reconstruction may be treated as standard assets during the planning period, if any.
- Provisioning requirements:
  - **Sub-standard assets:** 10% of the outstanding amount
  - **Doubtful assets:**
    - 100% provision to the extent the asset is not covered by the estimated realizable value of security.
    - 50% of the remaining outstanding amount, in addition to above
  - **Loss asset:** The entire asset shall be written off.

Governance and conduct

Individuals cannot serve as Managing Director (MD), Chief Executive Officer (CEO), or Whole-time Directors (WTD) of an ARC beyond 70 years, with ARCs having the discretion to set a lower retirement age; the tenure is limited to five years at a time, with re-appointment possible but not exceeding fifteen years continuously. Board meetings require a quorum of one-third of the Board's strength or three directors, whichever is higher, and the Chair to be an independent director.

- **Audit Committee:** Audit Committee to consist of only non-executive directors, meet quarterly with a quorum of three members and review and assess the effectiveness of internal control systems, especially with respect to the asset acquisition procedures and asset reconstruction measures.
- **Nomination and Remuneration Committee:** ARCs shall constitute a Nomination and Remuneration Committee of the Board which shall have the same powers, functions and duties as laid down in Section 178 of the Companies Act, 2013.
- **Fair Practices Code:** ARCs are advised to put in place a Board-approved Fair Practices Code in order to achieve the highest standards of transparency and fairness in dealing with stakeholders. Illustrative list includes the following:
  - Follow transparent, non-discriminatory practices in acquisition of assets and ensure arm's length transactions.
  - Release all securities on full repayment or realisation of the outstanding loan amount, subject to any legitimate right or lien for any other claim against the borrower.
  - A Board-approved policy on the management fee, expenses and incentives, if any, claimed from trusts under their management.
  - Prevent any form of intimidation or harassment in debt collection.
  - The Fair Practices Code shall be placed in public domain for information of all stakeholders.

Accounting and Disclosures

- ARCs to prepare their financial statements, including the balance sheet and profit and loss account, annually on 31 March.
- ARC to categorize liabilities due within a year as 'current liabilities' and assets due within a year, plus cash and bank balances, as 'current assets'.
- The accounting policies used to align with the prudential norms set by the RBI. Any deviations from these guidelines are required to be clearly disclosed, stating the reasons and financial impact, or if the impact is unascertainable, this fact must be stated with reasons. Merely disclosing accounting policies or notes cannot correct improper treatment of items in the financial statements.
- ARCs covered by Rule 4 of the Companies (Indian Accounting Standards) Rules, 2015 are required to comply with Indian Accounting Standards (Ind AS) for the preparation of their financial statements. To promote a high quality and consistent implementation as well as facilitate comparison and better supervision, the RBI has issued regulatory guidance on Ind AS vide circular DOR (NBFC).CC.PD.No.109/ 22.10.106/2019-20 dated 13 March 2020 which, along with subsequent instructions on the subject, is applicable on such ARCs for preparation of their financial statements from financial year 2019-20 onwards.
- **Investments:** Investments in SRs, due to their reliance on cash flows from NPAs, are classified as available for sale (AFS), with any net depreciation accounted for and net appreciation disregarded. All other investments to be valued at lower of cost or realisable value.
- Income recognition
  - Yield on SRs and upside income to be recognised only after the full redemption.
  - Management fees to be calculated and charged as a percentage of the NAV calculated at the lower end of the recovery rating specified by the credit rating agency (CRA), provided that the same is not more than the acquisition value of the underlying asset and may be recognized on accrual basis.
  - Interest and any other charges on NPAs to be recognised only upon actual realisation. Any unrealised income recognised, before the asset became NPA to be derecognised.
  - The income recognition on all other items shall be based on recognised accounting principles.
- ARCs preparing their financial statements as per Ind AS, shall reduce the following (net of any specific ECL allowances and the tax implications thereon) from NOF while calculating CAR and amount available for payment of dividend:
  - Management fee recognised during the planning period that remains unrealised beyond 180 days from the date of expiry of the planning period.
  - Management fee recognised after the expiry of the planning period that remains unrealised beyond 180 days of such recognition.
  - Any unrealised management fee, notwithstanding the period for which it has remained unrealised, where the NAV of the SRs has fallen below 50% of the face value.
- **Pre-acquisition and post-acquisition stage expenses:** Pre-acquisition stage expenses for performing due diligence etc. for acquiring financial assets from banks/ financial institutions needs to be expensed immediately in profit and loss in the period in which such expenses are incurred. Expenses incurred at post-acquisition stage for formation of the trusts, stamp duty, registration, etc. and which are recoverable from the trusts, are to be reversed, if these expenses are not realised within 180 days from the planning period or downgrading of SRs, i.e., NAV is less than 50% of the face value of SRs, whichever is earlier.
- **Disclosures in balance sheet:** Every ARC shall, in addition to the requirements of Schedule III of the Companies Act, 2013, prepare the following schedules and annex to its balance sheet (illustrative list):
  - Names and addresses of the banks/ financial institutions from whom financial assets were acquired and the value at which such assets were acquired from each such bank/ financial institution.
  - Segregation of various financial assets industry-wise and sponsor-wise (to be indicated as a percentage of the total assets)
  - Details of related parties as per the Accounting Standards and the amounts due to and from them.
  - A statement clearly charting therein the migration of financial assets from standard to non-performing.
  - Value of financial assets acquired during the financial year either on its own books or in the books of the trust.
  - Value of financial assets realized during the financial year.
  - Value of financial assets outstanding for realisation as at the end of the financial year.
  - Value of SRs redeemed partially, and the SRs redeemed fully during the financial year.
  - Value of SRs pending for redemption as at the end of the financial year.
  - Value of SRs which could not be redeemed as a result of non-realisation of the financial asset as per the policy formulated by the ARC.

- Value of land and/ or building acquired in ordinary course of business of reconstruction of assets (year wise)
- The basis of valuation of assets if the acquisition value of the assets is more than the book value of the transferors.
- The details of the assets disposed of (either by write off or by realisation) during the year at a discount of more than 20% of valuation as on the previous year end and the reasons therefor.
- The details of the assets where the value of the SRs has declined more than 20% below the acquisition value.
- Information about outsourced agency, if owned/ controlled by a director of the ARC.
- Information about assets acquired under IBC including the type and value of assets acquired, the sector-wise distribution based on business of the corporate debtor.
- Implementation status of the resolution plans approved by the Adjudicating Authority on a quarterly basis.
- Information on the ageing of the unrealised management fee recognised in their books in the format (specified in the Circular) as part of the Notes to Accounts in the annual financial statements (applicable only to ARCs preparing their financial statements as per Ind AS).

- Submission of returns as per RBI Master Direction - Reserve Bank of India (Filing of Supervisory Returns) Directions - 2024.
- ARCs are required to submit their audited balance sheet, Directors' Report, and Auditors' Report to the RBI's Regional Office of the Department of Supervision within one month of their AGM.
- ARCs are required to report to the Department of Supervision of the RBI, any instances where they have changed or taken over the management of a borrower's business for debt recovery.
- ARCs shall display information in respect of the borrowers whose secured assets have been taken into possession by them, under the Act and upload this information on their website in the specified format.

Other miscellaneous points

ARCs to become members of all Credit Information Companies (CICs) and submit data as per the RBI's Uniform Credit Reporting Format. They are required to update this information fortnightly or at an agreed shorter interval and are required to rectify rejected data within seven days. ARCs need to establish a Standard Operating Procedure (SOP) for CIC-related matters, ensuring accurate customer data submission, regular record updates, and proper reporting of repayments, including the last instalment. To avoid repayments not being updated, ARCs may centralize No-Objection Certificate issuance and appoint a nodal officer for CIC co-ordination. Customer grievance redressal, particularly concerning credit information updates, are required to be prioritized and integrated into existing systems. ARCs may comply with stipulated timelines under CIC regulations for data updates, dispute resolution, and alterations, with any deviations monitored and reported to the Board. ARCs shall report to IBA the details of chartered accountants, advocates and valuers (who have committed serious irregularities while rendering their professional services) for inclusion in the IBA database of third-party entities involved in fraud.

How we see it

The new guidelines are designed to boost the efficiency, oversight, and resilience of ARCs, ultimately aiding in the more effective resolution of distressed assets within India's financial ecosystem. However, adhering to these updated regulations may prove demanding for ARCs, with smaller entities facing the brunt of the challenge. To align with the RBI stipulations, ARCs will have to allocate time and capital towards refining their governance structures.

Moreover, ARCs are expected to either establish or enhance their IT systems to meet stringent reporting obligations and manage data proficiently. This necessity for increased automation, sophisticated reporting mechanisms, and fortified data protection will exert considerable pressure on their current technological frameworks.

The directives also introduce more rigorous standards for asset categorization, provisioning norms, and revisions to the securitization framework, necessitating ARCs to bolster their risk management practices, revise internal procedures, and invest in advanced systems for accurate asset classification and management. The guidelines emphasis on accounting treatment for investments along with their valuation, income recognition and disclosure requirements, significantly impact ARC's financial reporting and regulatory compliances.

Furthermore, ARCs are required to institute strong internal audit functions and compliance frameworks to be in step with the new regulatory demands, particularly in relation to KYC protocols and AML regulations.

10. Draft Disclosure framework on Climate-related Financial Risks, 2024

Draft circular date: 28 February 2024

Effective date: In phased manner as detailed under heading 'Commencement' below.

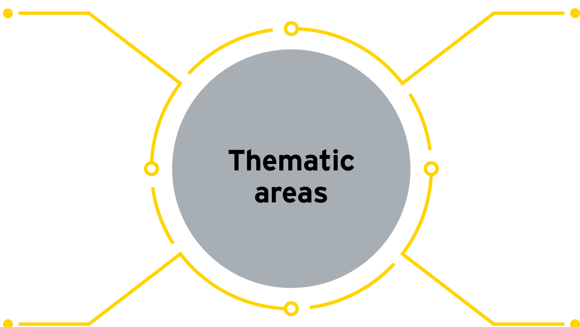
Applicability: Regulated Entities (RE):

- All Scheduled Commercial Banks (SCBs) (excluding Local Area Banks, Payments Banks and Regional Rural Banks (RRB))
- Tier-IV Primary (Urban) Co-operative Banks (UCBs)
- All-India Financial Institutions (viz. EXIM Bank, NABARD, NaBFID, NHB and SIDBI)
- Top and Upper Layer (UL) NBFCs
- Foreign banks shall make disclosures specific to their operations in India.

REs shall disclose the information detailed in these guidelines on a standalone basis and not consolidated basis.

Climate-related risks are emerging as critical threats with the potential to significantly impact the financial stability of entities. The increasing challenges posed by climate change—ranging from physical damages and shifts in market perception to the transition toward sustainable products and services—underscore the inevitability of its effects. To foster a more consistent and comparable disclosure framework, the RBI has issued an exposure draft on climate-related risk disclosures. These disclosures aim to facilitate early identification and assessment of financial risks and opportunities associated with climate change. REs will be required to provide the prescribed information on a standalone basis, rather than on a consolidated basis.

Accordingly, the circular requires disclosure covering four main thematic areas (Pillars):



Risk management:

Overall risk management process of the RE along with the processes and policies pertaining to identification, assessment and management of climate related risks could be disclosed.

Strategy:

RE's strategy including the below mentioned points to be disclosed:

- Time horizon for climate related risks and opportunities (Long, medium and short term).
- Impact of risks on RE's strategy, business activities etc.
- Resilience of strategy depending on multiple scenarios and their outcomes.

Governance:

Processes, controls and procedures used to identify, assess, manage and mitigate climate related financial risks should be in place. Senior management's role in monitoring and Board's oversight of climate related risk should be disclosed.

Metrics and targets:

The RE's shall disclose the metrics used by them to assess the risk and opportunities. Scope 1,2 and 3 greenhouse gases (GHG) emissions etc.

Annexure 1 to the draft guidelines prescribes minimum key disclosure requirements for the above thematic pillars.

Commencement

Applicability of the circular shall be in a phased manner in the following way:

Particulars	Disclosure on governance, strategy and risk management	Disclosure on metrics and targets
SCBs, All-India Financial Institutions, Top and Upper layer NBFCs	FY 2025-26 onwards	FY 2027-28 onwards
Tier IV UCBs	FY 2026-27 onwards	FY 2028-29 onwards
Disclosure requirements for the other REs shall be announced by RBI in due course.		

Validation/ scrutiny of the disclosures

- Disclosures shall be subject to internal control assessments and shall be reviewed by Board of Directors or a Committee of the Board.
- Disclosures must be included and disclosed as a part of the RE's financial results/ statements on its website.

How we see it

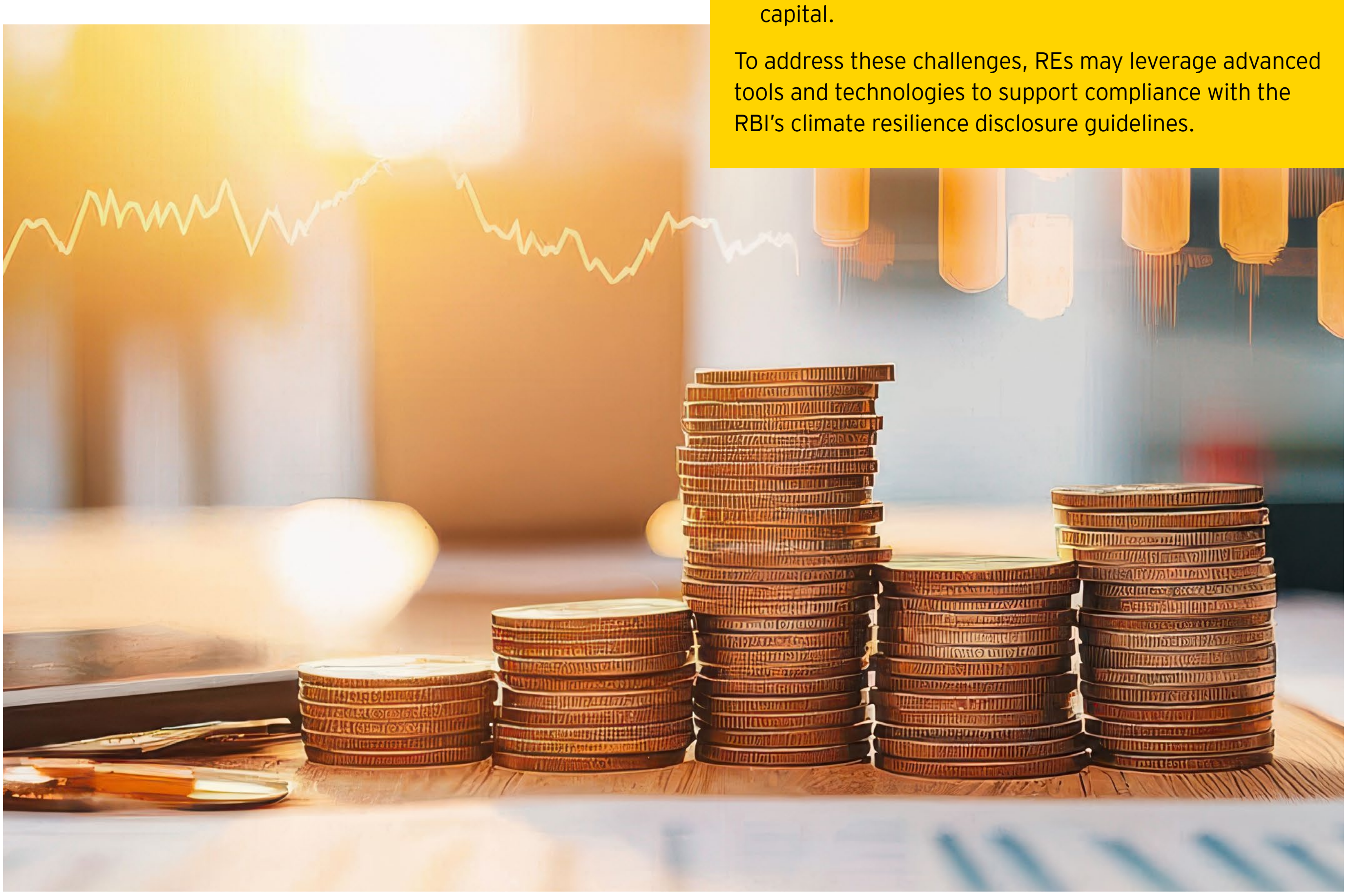
The current guidance requires REs to disclose climate-related financial risks based on four thematic pillars– Governance, Strategy, Risk Management, and Metrics and Targets. While the initiative aims to foster early assessment and market discipline, concerns exist regarding duplicative reporting burdens, as similar disclosures are already mandated by SEBI under the BRSR framework.

To avoid duplication and compliance burdens, the recommendation is that the RBI may consider aligning its disclosure framework with SEBI and other regulators, ensuring a unified and streamlined reporting mechanism. Instead of integrating these disclosures into financial statements, they may be part of REs' annual reports to maintain clarity and ease compliance.

REs may face several challenges in complying with the disclosure requirements due to:

- Data-related limitations, such as issues with granularity, historical availability, and reliability.
- Absence of standardized methodologies.
- Compliance burden associated with new regulations.
- Resource constraints, including financial and human capital.

To address these challenges, REs may leverage advanced tools and technologies to support compliance with the RBI's climate resilience disclosure guidelines.



11. Credit/ Investment Concentration Norms - Credit Risk Transfer

Circular date: 15 January 2024

Effective date: 15 January 2024

Applicability: All NBFCs including HFCs

The guidelines on Large Exposure Framework (LEF) are applicable to NBFCs-UL in terms of the Master Directions on NBFC, while the base and middle-layer (ML) companies are governed by credit and investment concentration norms prescribed under the Master Directions on NBFC, Master Directions on HFC and circular on Scale Based Regulations (SBR) - revised regulatory framework for NBFCs.

Following a comprehensive review of the extant concentration norms, below mentioned updates have been introduced to ensure uniformity and consistency in the computation of concentration norms among NBFCs:

Computation of exposure - Credit risk transfer instruments

- Aggregate exposure to a counterparty:
  - On balance sheet exposure are taken at outstanding amount and off-balance sheet exposure are converted into a credit risk equivalent by applying a credit conversion factor (CCF).
  - Exposures of NBFC-ML shall be offset with the below mentioned credit risk transfer instruments:
    - Cash margin / caution margin / security deposit held as collateral for which right to set off is available.
    - Central Government guaranteed claims which attract 0% Risk Weight for capital computation.
    - State Government guaranteed claims which attract 20% Risk Weight for capital computation.
    - Guarantees issued under the Credit Guarantee Schemes of Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE), Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH) and individual schemes under National Credit Guarantee Trustee Company Ltd (NCGTC) subject to meeting conditions of extant guidelines.

To be eligible as a credit risk transfer instrument, guarantees shall be direct, explicit, irrevocable, and unconditional.

- **Exemptions from credit/investment concentration norms:** Exposures to the Government of India and State governments which are eligible for 0% Risk Weight under capital regulations applicable to NBFCs and exposure where principal and interest are fully guaranteed by Government of India are exempted from credit/investment concentration norms.
- **Disclosures:** Where an NBFC has exceeded the prudential exposure limits during the year, the same is required to be disclosed in the annual financial statements.

Regulation for NBFC-Base Layer (BL)

NBFC-BL shall put in place an internal Board-approved policy for credit/investment concentration limits for both single borrower/party and single group of borrowers/parties, computation of which shall be on similar lines as mentioned above.

How we see it

The notification provides NBFC-ML with expanded measures to manage their exposure levels and specifies criteria to be met for an instrument to qualify as an eligible credit risk transfer mechanism. NBFC-BL, which previously operated without the constraints of concentration limits, are now mandated to establish a Board-approved internal policy that aligns with the aforementioned norms.

The review and update of the extant concentration norms carried out by the RBI ensures uniformity and consistency in computation of concentration norms among NBFCs and to facilitate proper and reliable comparison for users.

12. Draft guidelines: Basel III Framework on Liquidity Standards – Liquidity Coverage Ratio (LCR) – Review of Haircuts on High Quality Liquid Assets (HQLA) and Run-off Rates on Certain Categories of Deposits

Draft circular date: 25 July 2024

Effective date: 01 April 2025 (Expected implementation post 31 March 2026)

Applicability: Regulated Entities (RE):

- All Commercial Banks (excluding Payments Banks, RRB, and Local Area Banks).

The Liquidity Coverage Ratio (LCR) was introduced in 2009 as a response to the 2008 financial crisis to improve the management and oversight of liquidity in financial institutions. This measure was a key component of the broader "Basel III post-crisis reforms," designed to strengthen regulation, supervision, and risk management in the banking sector. In India, the RBI implemented the LCR on 01 January 2015, following the issuance of the Indian framework for LCR requirements on 09 June 2014.

The Liquidity Coverage Ratio (LCR) is a regulatory framework intended to ensure financial institutions maintain sufficient high-quality liquid assets (HQLA) that can be quickly converted to cash. The objective of the LCR is to satisfy short-term liquidity needs during periods of financial stress, specifically over a 30-day period. Currently, banks are required to maintain a 100% LCR.

LCR = HQLA / Total Net Cash Outflows over 30 days

Where,

HQLA = ∑ (Unweighted Amount * Factor multiplier)

Net cash outflows over 30 days = ∑ (Unweighted Amount * Run off Factor)

As per Circular RBI/2019-20/217/DOR.BP.BC. No.65/21.04.098/2019-20, LCR requires banks to maintain HQLAs to meet 30 days net outgo under stressed conditions. Further, as per Banking Regulation Act, 1949, banks in India are required to hold liquid assets to maintain Statutory Liquidity Ratio (SLR). Thus, banks are allowed to use a progressively increasing proportion of the SLR securities for being considered as HQLAs for LCR.

High Quality Liquid Assets (HQLA)

Liquid assets comprise of high-quality assets that can be readily sold or used as collateral to obtain funds in a range of stress scenarios. They shall be unencumbered. Assets are considered HQLA if they can be easily and immediately converted into cash at little or no loss of value. The liquidity of an asset depends on the underlying stress scenario, the volume to be monetized and the period considered. Nevertheless, there are certain assets that are more likely to generate funds without incurring large discounts due to fire-sales even in times of stress.

These are categorized as Level 1 and Level 2 assets. Level 2 assets are further classified as Level 2A and Level 2B assets. Level 1 assets include cash, excess cash reserve ratio (CRR) balance, central bank reserves and high-quality sovereign bonds.

Run off factor

Run-off factor represents the percentage of a bank's liabilities that are expected to 'run off' or be withdrawn during a 30-day stress period, which is used for calculating LCR.

Internet and Mobile Banking facilities (IMB)

As stated in the draft circular, Internet and Mobile Banking facilities (IMB) includes all facilities such as, but not limited to, internet banking, mobile banking, and Unified Payments Interface (UPI) which enables a customer to digitally transfer funds from their accounts.

Changes in LCR framework

Following are the changes that the RBI has made to enhance banks' liquidity resilience:

- Banks shall assign an additional 5% run-off factor while calculating weighted amount of net cash outflows within next 30 days for retail deposits which are enabled with IMB, i.e., stable retail deposits and less stable deposits, enabled with IMB shall have 10% and 15% run-off factor, respectively.
- Unsecured wholesale funding provided by non-financial small business customers shall be treated in accordance with the treatment of retail deposits, thus banks shall assign additional 5% run-off factor for these as well.

After making such adjustments to run-off factors, these will be as follows:

Category	Existing run-off factor (%)	Revised run-off factor (%)
Stable retail deposits - IMB	5%	10%
Less stable retail deposits - IMB	10%	15%
Stable unsecured wholesale funding - IMB	5%	10%
Less stable unsecured wholesale funding - IMB	10%	15%

Since run-off factor is more, for calculating net cash outflows over the 30-day period, banks will have more cash outflows, which then requires banks to hold/keep more HQLAs to maintain their 100% LCR.

- Unweighted amount for Level 1 HQLA in the form of Government securities shall be valued below their current market value, adjusted for applicable haircuts in line with the margin requirements under the Liquidity Adjustment Facility (LAF) and Marginal Standing Facility (MSF) as per table below:

Category of Collateral	Residual Maturity of Collateral				
	0-1 year	1-5 year	5-10 year	10-15 year	>15 year
Treasury Bills and Central Government Dated Securities (including Oil Bonds)	0.5%	1%	2%	3%	4%
State Development Loans (SDLs) (unrated)	2.5%	3%	4%	5%	6%
SDLs (rated)	1.5%	2%	3%	4%	5%

- For calculations of HQLA, banks now have to apply haircut of above-mentioned values for Level 1 HQLA in the form of Government Securities for calculating weighted amount after applying multiplier to unweighted amounts. This requirement pushes banks to keep more HQLA to maintain 100% LCR.
- If a deposit is contractually pledged to a bank as collateral to secure a credit facility or loan then subject to some conditions, banks may exclude such pledged deposit from the LCR calculation. However, this treatment does not apply to a deposit which is pledged against an undrawn facility. In such cases, such deposit (for instance, a non-callable fixed deposit), shall be treated as callable for LCR purposes.

How we see it

The growing integration of technology has enabled instantaneous bank transfers and withdrawals, as well as increased associated liquidity risks. Hence, proactive management strategies are required to handle such liquidity risk of banks. An increase in run-off factor for calculating net cash outflows within next 30 days will lead to more cash outflows of the banks, which then mandates banks to have more HQLA to maintain required LCR. On the other hand, liquid assets are marked downgraded as haircut is applied to Level 1 HQLA that are government securities, which will lead banks to have more HQLA in the form of Government Securities to maintain required LCR.

These guidelines are designed to ensure that banks in India are well-equipped to handle sudden withdrawals through digital channels or mobile banking-enabled facilities during stress scenarios, reflecting preparedness for situations observed globally. Once implemented, these guidelines may necessitate banks to allocate more liquid assets to manage potential withdrawal demands effectively.

Further, adjusting the valuation of HQLAs below market value with maturity-based haircuts ensures more conservative and accurate liquidity assessments. Since these adjustments will leave lesser amount with banks to lend and advance for operations while interest expense remains unchanged, it leads to slightly lower net interest margin (NIM). Hence, such adjustments could impact profitability and market lending capabilities of banks as costs of maintaining higher liquidity can be more than what it was before these guidelines.

Further, with respect to implementation of above guidelines, during its Monetary Policy Press Conference dated 07 February 2025, the RBI mentioned that entities would be allowed sufficient time for implementation. The RBI believes that period up to 31 March 2025 would not be an appropriate time horizon for complying with LCR guidelines. Further, it is expected that the implementation would not be earlier than 31 March 2026.

13. Streamlining of Internal Compliance monitoring function – leveraging use of technology

Circular date: 31 January 2024

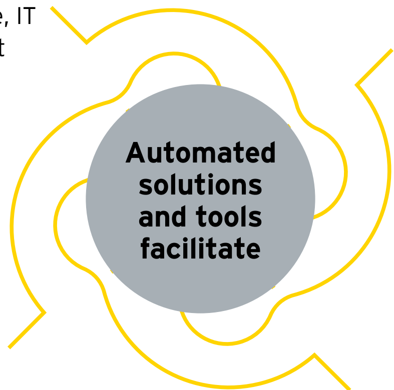
Effective date: 30 June 2024

Applicable: Regulated entities (REs)

- SCB (excluding RRB),
- SFBs,
- Payments Banks, UCBs (Tier III and IV),
- Upper- and Middle-Layer NBFCs (including HFCs),
- CIC and
- All India Financial Institutions (EXIM Bank, NABARD, NaBFID, NHB and SIDBI)

The RBI has directed implementing comprehensive, integrated, enterprise-wide and workflow-based solutions/tools to enhance the effectiveness of internal compliance monitoring by 30 June 2024.

A process is to be established for periodic review and adequacy of compliance monitoring systems.



Seamless communication and collaboration among stakeholders, including business, compliance, IT teams and senior management

Processes for identifying, assessing monitoring and managing compliance requirements

Record approvals for deviations or delays in compliance submissions and mechanisms to escalate non conpliance issues

Unified dashboard for senior management to gain a comprehensive view of the regulated entity's overall compliance status.

How we see it

Based on the RBI's assessment of the prevailing system in place for internal monitoring of compliance with regulatory instructions and the extent of usage of technological solutions, through this circular the RBI emphasizes the need for and importance of financial entities to leverage advanced technology for internal compliance monitoring. It mandates use of automated tools, periodic system testing, data analytics, and regular reviews based on size and complexity of the operations of entities to strengthen the compliance framework.

To comply with the requirements of this notification, REs may need to invest in technology that enables them:

- to enhance their existing compliance risk assessment methodology;
- helps in streamlining and creating an efficient mechanism for tracking queries/ information within organization;
- assists in logging and monitoring action plans towards regulatory inspection findings and
- creates a mechanism for follow ups, etc.

14. Review of Master Direction - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017

Circular date: 16 August 2024

Effective date: Immediate effect with one exception i.e., applicability of Balance in escrow account for T+1 day is effective from 15 November 2024.

Applicability: All NBFC-Peer to peer lending platform (P2P)

In response to evolving market practices and concerns about the integrity of peer-to-peer (P2P) lending activities, the RBI has taken steps to strengthen its regulatory oversight. On 16 August 2024 and 09 September 2024, the RBI issued amendments to the Master Direction - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017. These amendments aim to address emerging concerns related to the functioning of NBFC-P2P lending platforms, which had been observed to adopt practices that violated the established guidelines.

Such practices included improper funds transfer mechanisms, the promotion of P2P lending as an investment product with guaranteed returns, and actions resembling deposit-taking rather than platform facilitation. The amendments seek to clarify and modify provisions to ensure a more robust regulatory framework, ensuring that NBFC-P2P lending platforms operate as intended strictly as intermediaries providing online marketplaces for P2P lending.

Some of the key changes introduced by these amendments and their implications for the sector are given below:

- **No assumption of credit risk:** NBFC-P2P platforms cannot assume any credit risk related to transactions on their platform. Any loss of principal or interest will be borne solely by the lenders, with clear disclosures made to lenders as part of the Fair Practices Code.
- **Prohibition on cross-selling:** NBFC-P2P platforms are prohibited from cross-selling insurance products which is in the nature of credit enhancement or credit guarantees.
- **Use of lender funds:** Lender funds are to be deployed only as specified in the Directions.
- **No fund substitution:** NBFC-P2P platforms cannot use one lender's funds to replace another lender's fund.
- **Loan disbursement:** No loan shall be disbursed unless the lenders and borrowers are matched/mapped as per the Board-approved policy, the individual lenders have approved the recipients, and all participants have signed the loan contract. The matching process is to be conducted in an equitable and non-discriminatory manner, ensuring fairness in the selection of borrowers.
- **Pricing policy:** The pricing policy of NBFC-P2Ps shall be objective and transparent. All fees applicable to a loan are to be disclosed upfront, i.e., at the time of lending. These fees are either be a fixed amount or a fixed percentage of the principal amount. Importantly, the fees shall not be contingent upon the borrower's repayment.
- **Closed user group prohibition:** The revised guidelines prohibit the practice of matching/mapping participants within a "closed user group," whether sourced through an outsourced agency or other means. A "closed user group" refers to borrowers or lenders sourced through affiliates or service providers to the NBFC-P2P, which could lead to potential biases or unfair practices.
- **Fund transfer:** Funds are to be transferred using two separate escrow accounts: one for lender funds (Lenders' Escrow Account) and one for borrower repayments (Borrowers' Escrow Account). Lender funds are to be transferred to the Lenders' Escrow Account and disbursed to the borrower only after matching requirements are confirmed. Borrower repayments is to be made from the borrower's bank account to the Borrowers' Escrow Account and then transferred to the lender. Cash transactions are prohibited, and all transfers shall be through bank accounts. Funds are not required to remain in escrow accounts for more than T+1 day, effective from 15 November 2024.
- **Consent of borrower:** NBFC-P2Ps to disclose borrower details to lenders, including personal identity with borrower's consent, loan amount, interest rate sought, and credit score calculated by the platform.
- **Disclosure of losses borne by lenders:** NBFC-P2Ps are required to publicly disclose portfolio performance on their website, including the share of NPAs on a monthly basis, with segregation by age. This disclosure shall also include any losses borne by lenders, either on principal, interest, or both.
- **Brand name and registration:** NBFC-P2Ps may prominently display their registered name and any brand name on all customer interfaces, promotional materials, and communications with stakeholders and participants.

- **No loan recovery guarantee:** The P2P platform shall not offer any assurance or guarantee regarding the recovery of loans. Additionally, it shall not promote P2P lending as an investment product that includes features such as assured minimum returns, liquidity options, or other guarantees.
- **Mandatory disclaimer:** The platform may prominently display the caveats as mentioned in the direction on its website, mobile/web applications, and all promotional materials.
- **Credit Information Reporting:** NBFC-P2Ps to ensure that credit information related to borrower transactions is kept up-to-date and reported regularly. From 01 January 2025, credit information shall be updated fortnightly or at shorter intervals as agreed with the CICs. The submission to CICs shall be within seven calendar days of the reporting fortnight.
- **Experience of the Board:** At least one director of the NBFC-P2P to have relevant experience working in a bank or NBFC to ensure professional expertise in managing the affairs of the platform.
- **Risk Management Committee (RMC):** NBFC-P2Ps are required to establish an RMC at the Board or executive level. The RMC will be responsible for evaluating the platform's overall risks and reporting to the Board.
- **Outsourcing restrictions**
  - NBFC-P2Ps are prohibited from outsourcing core management functions, including Internal Audit, Strategic and Compliance functions, pricing of services/ fees to borrowers/lenders, and decision-making functions such as determining compliance with KYC norms.
  - For NBFC-P2Ps within a group or conglomerate, these functions may be outsourced within the group, subject to compliance with relevant instructions.
  - While the internal audit function is a management process, the internal auditors can be on contract.

How we see it

The RBI's recent amendments to the 2017 Directions for NBFC-Peer to Peer Lending Platforms significantly tighten the operational and regulatory framework for P2P lending in India. These changes aim to safeguard the interests of participants by enforcing transparent practices, prohibiting the assumption of credit risk by platforms, and enhancing disclosure requirements. The amendments are expected to foster a more secure and fair lending environment, ensuring that P2P platforms operate strictly as intermediaries without engaging in risk intensive or biased activities.

15. Capital Adequacy Guidelines – Review of Trading Book

Circular date: 28 February 2024

Effective date: 01 April 2024

Applicability: All Commercial Banks (excluding Regional Rural Banks)

The RBI circular titled "Capital Adequacy Guidelines – Review of Trading Book," introduces significant amendments to the capital adequacy framework.

Key amendments are as follows:

- **Alignment with Investment Portfolio Directions:** The circular aligns capital adequacy guidelines with the Master Direction on Classification, Valuation, and Operation of Investment Portfolio of Commercial Banks (Directions), 2023, dated 12 September 2023. This alignment introduces a clearly identifiable trading book under the 'Held for Trading (HFT)' accounting sub-classification and incorporates the Available for Sale (AFS) reserve into regulatory capital.
- **Revised definition of Trading Book:** The revised definition of the trading book for capital adequacy purposes is updated as follows, "Please refer to Master Direction - Classification, Valuation and Operation of Investment Portfolio of Commercial Banks (Directions), 2023 dated 12 September 2023. Accordingly, a) investments in subsidiaries, associates and joint ventures would be part of banking book; b) unlisted equity would be part of banking book [Fair value through Profit & Loss (FVTPL) (non-HFT), or under AFS in terms of clause 6.2(a) of Directions]; and c) listed equity is generally part of trading book (classified under HFT), unless such investment is classified under AFS in terms of clause 6.2(a) of Directions."
- **Amendment to the definition of Market Risk Capital Requirement:** The market risk capital charge is defined as the simple sum of the capital requirements arising from each of the three risk classes – namely interest rate risk, equity risk and foreign exchange risk. The risk-weighted assets for market risk shall be determined by multiplying the market risk capital charge by a factor of 12.5.

  In anticipation of transitioning to the 'Simplified Standardised Approach,' the existing market risk capital requirements have been recalibrated by introducing intermediate scalers as guided in the circular.

The scalars provided above are part of a transition arrangement. However, the final guidelines on 'Market Risk Capital Requirements – Simplified Standardised Approach' will be implemented at a later date, with detailed guidelines to be issued separately.

In anticipation of transitioning to the 'Simplified Standardised Approach,' the existing market risk capital requirements have been recalibrated by introducing intermediate scalers. Banks are advised to consider these changes in their strategic planning and capital management.

How we see it

The RBI's amendments to the capital adequacy guidelines represent a significant shift in the regulatory landscape for Commercial Banks in India. By aligning with the Master Direction on Investment and recalibrating market risk capital requirements, the RBI aims to enhance the stability of the banking sector. Following are the key implications for banks:

- Strategic and capital planning: Banks would be required to adjust their strategies and capital planning measures to comply with the recalibrated market risk capital requirements and the revised definition of the trading book. This may involve reassessing risk management practices and ensuring that capital reserves are sufficient to meet the new standards.
- Operational adjustments: The introduction of a clearly identifiable trading book under the HFT classification necessitates operational changes. Banks may ensure accurate classification and valuation of their investment portfolios in line with the new guidelines.
- Regulatory compliance: Incorporating the AFS reserve into regulatory capital requires banks to adjust their accounting practices to reflect this change.

16. Maintenance of Cash Reserve Ratio (CRR)

Circular date: 06 December 2024

Effective date: In phased manner as described below.

Applicability: All banks

The circular refers to the reduction in the Cash Reserve Ratio (CRR) of all banks, as announced in the Statement on Developmental and Regulatory Policies. The CRR has been reduced by 50 basis points (bps), to be implemented in two equal tranches of 25 bps each.

The CRR will be reduced from 4.25% of Net Demand and Time Liabilities (NDTL) to 4.00%.

The banks are required to maintain the CRR at 4.25% of their NDTL effective from the reporting fortnight beginning 14 December 2024 and 4.00% of their NDTL effective from fortnight beginning 28 December 2024.

How we see it

The circular refers to the reduction in the CRR of all banks which will increase the liquidity available in the banking system, which could potentially be used for lending and economic activities.

17. Master Direction – Reserve Bank of India (Commercial Paper and Non -Convertible Debentures of original or initial maturity up to one year) Directions, 2024

Circular date: 03 January 2024

Effective date: 01 April 2024

Applicability:

- Companies, including NBFCs and HFCs
- Infrastructure Investment Trusts (InvITs) and Real Estate Investment Trusts (REITs)
- All India Financial Institutions (AIFIs)
- Other body corporates with a minimum net worth of INR100 crore, statutorily permitted to incur debt or issue debt instruments in India.
- Co-operative societies and limited liability partnerships with a minimum net worth of INR100 crore [for Commercial Papers (CPs) only]
- Any other entity specifically permitted by the RBI.

All fund-based facilities availed by the issuer from banks, AIFIs, or NBFCs to be classified as 'Standard' at the time of issuance.

These directions aim to streamline the issuance and investment processes for Commercial Papers (CPs) and Non-Convertible Debentures (NCDs) with maturities up to one year.

Some of the key highlights are:

Instrument characteristics

- Tenor
  - CPs: Minimum of 7 days and a maximum of one year
  - NCDs: Minimum of 90 days and a maximum of one year
- Denomination
  - These instruments are issued in dematerialized form with a minimum denomination of INR5 lakh and multiples thereof.
- Issuance Conditions
  - These are plain vanilla instruments and issuance with call and put options is not permitted.
  - Underwriting or co-acceptance of CPs and NCDs is not permitted.
  - CPs shall be issued at a discount to the face value and NCDs shall be issued at a discount to the face value or with fixed or floating rate coupon.

- Credit Rating Requirement
  - Issuers shall have a minimum credit rating of 'A3' for the issuance of CPs and NCDs
- Roles and Responsibilities
  - **Issuing and Paying Agents (IPAs):** Responsible for verifying the issuer's authorization for borrowing through CPs/NCDs and ensuring compliance with relevant directives. They are responsible to maintain custody of certified copies of issuance-related documents and issue an IPA certificate upon satisfactory verification.
  - **Debenture Trustees:** To be guided by SEBI regulations, the Companies Act, 2013, the trust deed, and the offer document. They are responsible to ensure compliance with reporting obligations and provide required information to the RBI when requested.
  - **Credit Rating Agencies (CRAs):** To be registered with SEBI and accredited by the RBI as External Credit Assessment Institutions (ECAIs) for bank loan ratings. They are required to comply with SEBI guidelines applicable to securities ratings and adhere to RBI guidelines.
- Purpose of funds
  - Companies generally use these funds primarily to finance current assets and operating expenses.
  - If funds are to be used for other purposes, this is to be stated in the offer documents.
  - A certificate from the CEO / Chief Financial Officer (CFO) confirming the use of funds is to be provided to the IPA within three months of issuance.
- Buyback provisions
  - Buyback of CP and NCD is permitted at prevailing market prices, subject to:
    - CPs: Buyback allowed only after 7 days from the issue date.
    - NCDs: Buyback allowed only after 90 days from the issue date.
  - Instruments bought back is to be extinguished on the buyback date.
- Settlement and trading

  CPs and NCDs can be issued in primary market and traded in the secondary market over the counter (OTC) or on recognized stock exchange.
  - Issuers to appoint an IPA for CPs and both an IPA and a debenture trustee for NCDs.
  - Subscriptions to primary issues is to be routed through the IPA.
  - Settlement cycles shall either be T+0 or T+1 for OTC trades.
- Repayment obligations
  - Issuers to ensure repayment, including coupon payments, by 3:00 p.m. on the redemption date; no grace period is allowed.
  - In case of default, issuers to inform the IPA (and debenture trustee for NCDs) by 5:00 p.m. on the due date.
  - Defaulting issuers are barred from issuing CPs or NCDs until the defaulted obligation is paid or six months after the default date, whichever is earlier.

How we see it

The Master Directions aim to enhance transparency, standardization, and investor protection in the issuance and management of short-term CPs and NCDs. By setting clear eligibility criteria, issuance guidelines, and roles for intermediaries, the RBI seeks to strengthen the integrity and efficiency of the money market in India. Entities involved in the issuance or investment of these instruments to align their operations with the new directives to ensure compliance and maintain market stability.

B List of master directions updates

S.No	Direction update date	Direction number	Direction name	Remarks
1	01 January 2024	RBI/DCBR/2015-16/23	Master Direction - Reserve Bank of India (Co-operative Banks - Interest Rate on Deposits) Directions, 2016	Update in the Definition of 'Bulk Deposit' – Single Rupee Term Deposits: Scheduled UCBs (Tier 3 and Tier 4): Deposits of INR1 crore or more will now be considered bulk deposits. (Previously, the threshold was INR15 lakh.) Other UCBs in Tier 3 and Tier 4 (Non-Scheduled): The threshold for bulk deposits remains unchanged at INR15 lakh.
2	29 February 2024	RBI/DPSS/2023-24/111	Master Direction – Reserve Bank of India (Bharat Bill Payment System) Directions, 2024	These Master Directions aim to regulate and enhance the efficiency of bill payments, reflecting the RBI's commitment to building a robust and secure payment and settlement system in the country. The introduction of escrow account requirements for non-bank Bharat Bill Payment Operating Units (BBPOUs) helps ensure proper fund management, minimizing risks related to settlement and transaction failures. Expanding the definition of "bills" to include prepaid recharge notices widens the service scope, while centralized complaint management via NPCI Bharat BillPay Limited (NBBL) reflects a commitment to enhanced customer experience.
3	01 April 2024	RBI/DCM/2024-25/115	Master Direction on Counterfeit Notes, 2024 – Detection, Reporting and Monitoring	The issued Direction aims to enhance vigilance and combat the circulation of counterfeit currency by establishing clear procedures for detection, impounding, and reporting requirements.
4	01 April 2024	RBI/DCM/2024-25/112	Master Direction – Scheme of Penalties for bank branches and Currency Chests for deficiency in rendering customer service to the members of public	The Direction outlines measures to address deficiencies in customer service provided by bank branches and currency chests. This direction aims to ensure accountability and improve service standards for the public.
5	01 April 2024	RBI/DCM/2024-25/113	Master Direction on Framework of incentives for Currency Distribution & Exchange Scheme for bank branches including currency chests	The Direction introduces a framework of incentives under the Currency Distribution and Exchange Scheme (CDES) to encourage all bank branches to enhance customer service. It also outlines operational procedures aimed at improving services for the public. Through CDES, the RBI seeks to promote a robust financial ecosystem by establishing guidelines that facilitate smoother currency operations and ensure a clean and reliable currency supply nationwide.

S.No	Direction update date	Direction number	Direction name	Remarks
6	01 April 2024	RBI/DCM/2024-25/114	Master Direction on Penal Provisions in reporting of transactions / balances at Currency Chests	The RBI aims to uphold transparency and efficiency in currency management through this Direction – "Penal Provisions for Reporting Transactions/Balances at Currency Chests". The Direction emphasizes accurate and timely reporting of currency transactions. It outlines detailed reporting procedures, penalties for non-compliance, and operational guidelines to promote transparency, accuracy, and discipline among banks managing currency chests.
7	11 June 2024	RBI/FIDD/2017-2018/56	Master Direction - Lending to Micro, Small & Medium Enterprises (MSME) Sector	The Direction revises the timeline for credit decisions for MSE borrowers to 14 working days. Banks are encouraged to establish a structured mechanism to monitor credit growth in the MSE sector, adopt a cluster-based approach, and comply with reporting requirements for identified clusters.
8	10 October 2024	RBI/DoR/2023-24/106	Master Direction – Reserve Bank of India (Non-Banking Financial Company– Scale Based Regulation) Directions, 2023	The issuance of new guidelines under the Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023 replaces the earlier regulations issued in 2016 for different types of NBFCs.
9	10 October 2024	RBI/DNBR/2016-17/50	Master Directions - Mortgage Guarantee Companies (Reserve Bank) Directions, 2016	The issuance of new guidelines under the Master Directions – Mortgage Guarantee Companies (Reserve Bank) Directions, 2016 replaces the earlier regulations from 2015. These updated Directions further incorporate reference to the Guidance Note on Operational Risk Management and Operational Resilience to strengthen regulatory clarity and operational soundness.
10	08 November 2024	RBI/FMRD/2024-25/117	Master Direction – Reserve Bank of India [Margining for Non-Centrally Cleared OTC Derivatives (NCCDs)] Directions, 2024	Covered entities to prioritize readiness for compliance with the RBI's Master Directions on NCCDs. This includes: ▪ Establishing robust processes to verify counterparty eligibility for margin exchange. ▪ Implementing comprehensive risk management policies tailored to NCCD-related risks. ▪ Ensuring systems and procedures align with the margin exchange requirements to avoid penalties or operational disruptions. Timely preparation and adherence to these directives will mitigate risks, ensure regulatory compliance, and enhance market stability.

S.No	Direction update date	Direction number	Direction name	Remarks
11	30 July 2024	RBI/DPSS/2024-25/123	Master Directions on Cyber Resilience and Digital Payment Security Controls for non-bank Payment System Operators	The RBI aims to ensure safety and security of payment systems in the country; thus, initiatives are taken for enhancing the resilience of authorized non-bank Payment System Operators (PSOs) to both current and emerging risks related to information systems and cybersecurity. The measures outlined in this circular are intended to ensure that PSOs maintain robust cybersecurity practices, safeguard customer data, and mitigate potential cyber threats. The RBI's guidance is part of a broader effort to create awareness and enhance the overall security framework for payment systems in India.
12	06 September 2024	RBI/DNBR/2016-17/46	Master Direction - Non-Banking Financial Company - Account Aggregator (Reserve Bank) Directions, 2016	New-age digital lending NBFCs can go for the NBFC-AA license, as this would amount to a 'value add' to their services since every step in the loan process could be done without the customer having to leave the app. The revenue model may be structured in a way that the NBFC-AA reaps benefits out of its services provided to the NBFC. The ultimate benefit would be a speedy and easier credit approval and sanction process for the digital lending business. Data, coupled with consent of the customer, would prove more efficient for the new-age digital lending model if all the necessary checks and systems are in place.
13	07 June 2024	RBI/DBR/2015-16/19	Amendment to Master Direction - Reserve Bank of India (Interest Rate on Deposits) Directions, 2016	The RBI has directed change in definition of bulk deposits as per paragraph 3(a)(i) of the Master Direction - Reserve Bank of India (Interest Rate on Deposits) Directions, 2016 dated 03 March 2016. This amendment aims to align the classification of bulk deposits with current banking practices, promoting a more efficient and competitive banking environment.
14	09 February 2024	RBI/2023-24/121	Review of Fixed Remuneration granted to Non-Executive Directors (NEDs)	This circular provides guidance regarding the fixed remuneration of Non-executive Directors of banks. Remuneration of Non-executive Directors of the Board has increased from INR20 lakh per annum to INR30 lakh per annum depending on the size of the bank and other factors. Further, private sector banks are required to take regulatory approval regarding remuneration paid to part-time chairman. Banks are required to make disclosure on remuneration paid to directors in annual financial statements.

S.No	Direction update date	Direction number	Direction name	Remarks
15	27 February 2024	RBI/DoS.DSG/2023-24/110	Master Direction - Reserve Bank of India (Filing of Supervisory Returns) Directions - 2024	These Directions offer an exhaustive inventory of forms in the specified formats, intended to serve as a singular reference for all Supervised Entities (SEs). Additionally, these directives stipulate the mandatory online submission of all forms as well as emphasises higher degree of automation in generation of data for filing of returns. In essence, these directives necessitate that Senior Management review and revise their current policies to align with the requirements, thereby ensuring adherence to the directives and avoiding any potential fines or penalties.
16	06 January 2025	RBI/DoR/2024-25/125	Master Direction - Reserve Bank of India (Credit Information Reporting) Directions, 2025	This framework establishes standardized guidelines for credit information reporting, ensuring confidentiality, security, and consumer access to data. It promotes governance, compliance, and transparency for Credit Information Companies (CICs) and their members while enforcing strict measures for accuracy and dispute resolution. The Technical Working Group (TWG) and its Standing Sub-Group play a crucial role in refining data standards, addressing IT challenges, and adapting to regulatory changes, ultimately strengthening trust and accountability in India's credit reporting system.

C Other updates

Update on the Discussion Paper regarding ECL Framework Provisioning by Banks

On 16 January 2023, the RBI published a Discussion Paper on 'Introduction of an Expected Credit Loss (ECL) Framework for Provisioning by Banks.' The paper proposed a shift towards an ECL framework and posed several discussion questions. The RBI sought feedback, comments, and suggestions to be submitted by stakeholders by 28 February 2023.

Subsequent to the feedback period, the RBI established a nine-member committee to further delve into the ECL framework. This committee includes domain experts from academia and the industry, as well as representatives from select banks. The group is led by R. Narayanaswamy, a former Professor at IIM Bangalore.

As of now, the RBI has not yet released the final guidelines on the ECL framework. Additionally, during the Monetary Policy Press Conference held on 07 February 2025, the RBI indicated that financial entities will be granted ample time to prepare for the implementation of the ECL framework. At this stage, no definitive timeline has been established for the adoption of the ECL model.

2

Insurance

1 IND AS 117 Implementation for Indian Insurers

Based on the communication issued by the Insurance Regulatory and Development Authority of India (IRDAI) dated 10 January 2025 to all insurance companies regarding the preparation of proforma financial statements for FY 2023-24 and FY 2024-25, the IRDAI has expressed its intent to implement IND AS for Indian insurers at the earliest. The implementation will be guided by the insights and learnings gained from the preparation of these proforma financial statements.

While the actual date for the transition is yet to be finalized, this transformative shift mandates a comprehensive overhaul of financial reporting frameworks to meet global standards. While several leading insurers in India have largely completed their gap assessments and are progressing towards solution design and vendor selection, others are still in the midst of their gap analysis.

Consequently, it is imperative to concentrate on the next critical steps to ensure a smooth and successful implementation.

- Advance Solution Design and Vendor Selection
  - **Tailor solution designs-** Insurers who have completed their gap assessments to prioritize the customization of their solution designs. This involves defining system requirements that cater specifically to the complexities of IND AS 117, ensuring scalability and flexibility.
  - **Vendor evaluation and selection-** Engaging with potential vendors is a critical step. Insurers to conduct thorough due diligence, evaluating vendors based on their technical capabilities, industry expertise, and track record in implementing similar standards. Building strategic partnerships with vendors who can provide robust and compliant solutions will be key.
- For insurers still in gap assessment phase
  - **Accelerate gap analysis-** Insurers still conducting their gap assessments to expedite this process by leveraging insights from early adopters and global best practices. Identifying and documenting gaps in existing processes, systems, and data capabilities will form the foundation for subsequent phases.
  - **Prioritize critical areas-** Focusing on high-impact areas such as contract classification, risk adjustment methodologies, and data requirements will ensure that the most significant challenges are addressed promptly.
- Develop a comprehensive implementation plan
  - **Establish a dedicated project team-** Both groups of insurers to ensure they have a dedicated project team in place, comprising cross-functional expertise from finance, actuarial, IT, and risk management. Clear governance structures and leadership support are essential for driving the project forward.
  - **Set clear milestones-** A phased approach with well-defined milestones and timelines will help manage the complexity of the transition. Regular progress reviews and adjustments to the plan will ensure that the project stays on track.
- Upgrade Systems and Technology
  - **Enhance IT infrastructure-** Insurers to invest in upgrading their IT infrastructure to support the data-intensive requirements of IND AS 117. This includes adopting systems capable of handling complex calculations, large data volumes, and real-time processing.
  - **Ensure system integration-** Seamless integration between actuarial, finance, and reporting systems is vital. This integration will enable efficient data flow, reducing the risk of errors and improving the accuracy of financial reporting.
- Refine accounting policies and methodologies
  - **Define accounting policy choices-** Insurers to finalize their accounting policy choices, aligning them with the company's business model and risk profile. Strategic decisions in areas such as the choice of measurement models and presentation of financial statements will have significant impacts.
  - **Develop risk-adjustment methodologies-** Establishing a consistent and robust approach to calculating risk adjustments is crucial. This involves determining appropriate confidence levels, diversification benefits, and correlation factors to reflect the uncertainty inherent in insurance contracts accurately.

- Coordination with Ind AS 109 and other Ind AS
    - **Alignment of accounting policies:** Ensure that accounting policies for financial instruments under Ind AS 109 are aligned with the requirements of Ind AS 117, particularly concerning discount rates.
- Strengthen data governance and quality
    - **Implement data management frameworks:** A strong data governance framework is essential for ensuring data accuracy, completeness, and consistency. The framework is to include policies and procedures for data collection, storage, and processing.
    - **Conduct data cleansing:** Insurers to prioritize data cleansing initiatives to address any quality issues. Ensuring that the data used in financial reporting is accurate and reliable will be critical for compliance with Ind AS 117.
- Provide training and change management
    - **Educate Stakeholders:** Comprehensive training programs to be developed for all relevant stakeholders, including Board members, finance teams, and operational staff. Tailored training sessions will help build competency and understanding of the new standards.
    - **Manage Organizational Change:** Effective change management strategies are necessary to address the cultural and operational shifts associated with Ind AS 117. Continuous communication, engagement, and support will help employees adapt to the new requirements.
- Engage with external stakeholders
    - **Collaborate with auditors and regulators:** Proactive engagement with auditors and regulatory bodies is crucial. Early feedback and guidance will help insurers navigate ambiguities and align on interpretations, ensuring smoother compliance.
    - **Communicate with investors and analysts:** Transparency with investors and analysts is key to managing expectations. Insurers to clearly communicate the anticipated impact of Ind AS 117 on their financial performance, providing clarity and building trust.
- Conduct dry runs and parallel reporting
    - **Perform trial runs:** Trial runs are essential for testing systems and processes under the new standard. These runs will help insurers identify and resolve operational challenges, ensuring readiness for the official implementation.
    - **Analyse and refine:** Analysing the results of trial runs will provide valuable insights. Insurers to use these insights to fine-tune their reporting processes, ensuring compliance and accuracy in financial statements.
- Monitor global implementation experiences
    - **Learn from global peers:** Examining global implementation experiences offers valuable insights. Insurers to learn from the challenges encountered and the solutions adopted by their peers in other markets, integrating best practices to strengthen their own implementation strategies. Globally, key challenges have included issues related to data granularity, significant process and control gaps, resource management, etc. Being aware of these challenges in advance allows insurers to implement the necessary solutions proactively.
    - **Adapt and innovate:** Adapting proven strategies and innovating where necessary will help insurers address the unique challenges of the Indian market. Leveraging global insights will position insurers for a successful transition to Ind AS 117.

2 Master Circular on Actuarial, Finance and Investment Functions of Insurers

The regulations aim to promote robust management practices for actuarial, finance, and investment functions, encompassing valuation, accounting, reporting, risk management, and solvency. They seek to improve transparency, accountability, and financial management within insurance companies. Previous circulars on financial statements, premium recognition, and related topics have been consolidated into this Master Circular, which includes a list of the repealed circulars.

Applicability

All life, general and health insurers, reinsurers and foreign reinsurance branches in India.

- Key changes compared to the earlier circulars:

  Majority of the circular is a compilation of earlier circulars and arranged is a more systematic way for easy reference and understanding. However, below are some key changes that have been observed.

  - Unit-Linked Insurance Policy (ULIP) disclosures (Life insurance)

    In case of life insurance, for Unit-Linked Insurance Policies, the Revenue Account, Balance Sheet and the underlying Schedules, including additional disclosures (Annexure XI), are required to be the part of ULIP disclosures on the website of the Insurer. Earlier, the requirement was to include the said disclosures as a part of Annual Report.

  - Premium recognition for long-term products (General insurance)

    In case of a premium for a long-term policy being collected for entire duration of the contract or for any duration exceeding 12 months, the recognition of the premium shall be on a yearly basis and any excess amount collected for later financial years shall be treated as “Premium Deposit” or “Advance Premium”. This change is effective 01 October 2024.

  - Payment of commission for long-term products (General insurance)

    The commission paid will be based only on the gross written premium recognised for the year in case of the above-mentioned long-term products. This change is effective 01 October 2024.

How we see it

The revised premium recognition approach for long-term products will lead to a lower gross written premium in a financial year for general insurance companies offering such products. The reduction in gross written premium is primarily a timing difference, as the differential premium recorded under “Premium Deposit” or “Advance Premium” will be recognized in the following years upon the commencement of risk.

The reduction in commissions will lead to an increase in operating profit for the financial year. However, similar to premium recognition, this impact is also a timing difference.

3 Insurance Regulatory and Development Authority of India (Actuarial, Finance and Investment Functions of Insurers) Regulations, 2024

Applicability

All life, general and health insurers, reinsurers and foreign reinsurance branches in India. The provisions will come into force on 01 April 2024.

Key changes compared to the earlier circulars:

- **Financial statements currency unit:** Financial figures in the statements may now be rounded off to the nearest lakh instead of thousands.
- **Segment reporting:** For general insurance companies, 'Travel' now needs to be reported as an additional sub-segment under 'Health'.
- **Revenue Account and Profit and Loss Account:** New disclosure line item introduced in the Revenue Account for Remuneration of MD/CEO/WTD/other KMPs under the "Contribution from Shareholders" Account section. Similar line has also been introduced in Profit and Loss Account under "Contribution to Policyholders' A/c".
- In addition to the above, certain changes that were previously part of the public disclosure formats have now been incorporated into the financial statements. Some of the examples are as below:
  - Additional disclosure for Gross Direct Premium between in India and outside India (General insurance)
  - The breakdown of operating expenses related to insurance business between in India and outside India (both life and general insurance)
  - Additional disclosure of gross benefits paid between in India and outside India (Life insurance)
  - Additional disclosure for claims paid (Direct) with bifurcation such as in India, outside India, estimates of "Incurred but not reported" (IBNR) and "Incurred but not enough reported" IBNER at the end of the period (net) and estimates of IBNR and IBNER at the beginning of the period (net) (General insurance)
  - The inclusion of "Investor" as an additional line item under the pattern of shareholding
  - Removed: Deposit with Reserve Bank of India [Pursuant to erstwhile section 7 of Insurance Act, 1938] (Life Insurance)

How we see it

By consolidating previous regulations into a unified framework, these regulations seek to improve the efficiency and responsiveness of insurers' actuarial, finance, and investment functions. They also introduce certain changes in the preparation of financial statements. While some of these changes are new, others—previously included in public disclosures—have now been incorporated into the financial statements of insurance companies.

4 Insurance Regulatory and Development Authority of India (Expenses of Management (EoM), including Commission, of Insurers) Regulations, 2024

Earlier, there were separate Expenses of Management (EoM) regulations for entities carrying on Life and General or Health insurance business. These have now been combined into a single regulation.

EoM include operating expenses related to life / general / health insurance business, commission paid to insurance agents, intermediaries, or insurance intermediaries and commission and expenses on inward reinsurance, charged to the Revenue Account.

Limits on EoM

- General insurance companies: Capped at 30% of the gross premium written in India during a financial year.
- Health insurers: Capped at 35% of the gross premium written in India during a financial year.
- Life insurers: Total expenses of management must not exceed the calculated amount based on specific percentages for various business segments.

There is no change in method of computation of allowable expense as compared to 2023 regulation.

Return of EoM

- Life insurers:

  IRDAI has prescribed a new format for return of EoM. Schedule I contains the format of the return for life insurers.

  The return is bifurcated in two major segments: Non-participating (including linked) and participating with further segregation as per Regulation 18 into Life, General Annuity & Pension, Health and Others (as specified by the Authority). However, the segments as per Regulation 18 are at granular level of Linked, Nonparticipating and Participating for monitoring, then Schedule I where linked and nonparticipating are combined for reporting.

  In the new format, the Authority has included the reporting of allowable expense and actual expense in a single format, which was earlier reported through Part A and Part B. The product-wise details such as Pure Risk products, Single Premium products, Group Fund-based policies, deferred annuity and details on lapsed policies under the revival period have been eliminated.

- General or Health insurers:

  There is no change in the return to be submitted by such insurers from the erstwhile regulation.

How we see it

The change primarily reflects an administrative consolidation, as the previously separate EoM regulations for Life and General Insurance have been unified into a single circular. This streamlining is accompanied by revisions specifically impacting the return format for Life Insurance, signalling IRDAI's effort to simplify regulatory frameworks while ensuring consistency across the industry.

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Tel: + 91 33 6615 3400

6th floor, Sector V, Building Omega
Bengal Intelligent Park, Salt Lake
Electronics Complex, Bidhan Nagar
Kolkata - 700 091
Tel: + 91 33 6615 3400

Mumbai
14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

3rd Floor, Unit No.301
Building No.1, Mindspace-Gigaplex
IT Park, MIDC, Plot No. IT-5
Airoli Knowledge Park
Airoli West, Navi Mumbai - 400 708
Tel: + 91 22 6192 0003

18th Floor, Altimus
Pandurang Budhkar Marg, Worli
Mumbai - 400 018
Tel: + 91 22 6192 0503

Pune
C-401, 4th Floor
Panchshil Tech Park, Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

10th Floor, Smartworks
M-Agile, Pan Card Club Road
Baner, Pune - 411 045
Tel: + 91 20 4912 6800

Ernst & Young Associates LLP

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