Year-end considerations

Financial services sector supplement

Updates of standards, interpretations and regulatory considerations affecting financial statements

April 2024

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We acknowledge

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Foreword

The year 2024 is going to be an interesting year for the Indian financial services sector due to the slowing global economy and multiple disruptive factors that are causing a fundamental shift in the way banking and capital markets are operating. The significant pace of new technologies, and the onset of multiple emerging trends, are influencing how banks/NBFCs operate and serve customer needs.

Our ongoing effort is to ensure that entities are well-informed about the latest updates and changes that are pertinent to finance and regulatory reporting teams.

As all entities gear up to finalize their financial statements for the year-ending 31 March 2024, it is critical that they evaluate all key changes in accounting and regulatory space which impacts financial and corporate 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 December 2023, relevant for financial year 2023-24 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 2024. 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 NBFCs
Section 2 – Insurance

Hope you all find the publication useful.

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Table of contents

Section 1: Banks and NBFCs

Section 2: Insurance

Section 1

Banks and NBFCs

A

Accounting and reporting related update

1. Guidelines on Default Loss Guarantee (DLG) in Digital Lending
2. Reserve Bank of India (Financial Statements – Presentation and Disclosures) Directions, 2021: Presentation of unclaimed liabilities transferred to Depositor Education and Awareness (DEA) Fund
3. Implementation of Indian Accounting Standards (Ind AS) – Asset Reconstruction Companies (ARC)
4. Master Direction – Classification, Valuation and Operation of Investment Portfolio of Commercial Banks (Directions), 2023
5. Framework for Compromise Settlements and Technical Write-offs
6. Investments in Alternative Investment Funds (AIFs)
7. Framework for acceptance of Green Deposits

01

Guidelines on Default Loss Guarantee (DLG) in digital lending

Effective date: 08 June 2023

Applicability-

- All commercial banks (including small finance banks)
- Primary (urban) co-operative banks, state co-operative banks
- Central co-operative banks
- NBFCs (including HFCs)

RBI laid down a regulatory framework for default loss guarantees (DLG) in digital lending after extensive consultations with stakeholders spanning over months. The guidelines permit default loss guarantee arrangements with the objective of lifting the cloud of uncertainty and bring relief to both:

- FinTech, by enabling them to form partnerships with banks and NBFCs
- Regulated lenders, which are looking to foray in new markets while still managing the risk

On September 2022, RBI had issued "Guidelines on Digital Lending." The guidelines made it clear that underwriting is the sole responsibility of the regulated entity (RE). Further, with regards to loss sharing arrangement involving contractual agreements such as First Loss Default Guarantee (FLDG) in which a third party guarantees to compensate up to a certain percentage of default in a loan portfolio of the RE, it advised RE to refer para 6l of Master Direction on Securitisation of Standard Assets, which states that lenders were not permitted to undertake or assume synthetic securitisation.

While Banks and NBFCs are RE, FinTech are not since they do not have a license that allows them to underwrite loans. They partnered with the RE and banked heavily on the FLDG arrangements to make good the loss. Under the master direction on securitisation , REs are not allowed to engage in arrangement involving synthetic structure. Consequently, the use of FLDG, which can be construed as a synthetic securitisation , was not permitted. This led to disruption in the FinTech industry and its partnership with RE, prompting FinTech to swiftly reassess their operating models and seek alternative survival strategies.

RBI has examined the arrangements between RE and Lending Service Providers (LSP) or between two REs involving DLG, commonly known as FLDG, and has decided to permit such arrangements. Such arrangement will no longer be treated as "synthetic securitisation " and will also not attract the provisions of "loan participation." Key highlights of this circular are given below:

- A RE, a (LSP) incorporated under the Companies Act, 2023 and have not entered in to and outsourcing LSP arrangement, would be eligible to enter into DLG arrangements with DLG.
- DLG arrangements must be backed by an explicit legally enforceable contract between the RE and the DLG provider containing details such as the Extent of DLG cover, Form in which DLG cover is to be maintained with the RE, Timeline for DLG invocation and Disclosure requirements.
- RE shall accept DLG only in one or more of the following forms:
  - Cash deposited with the RE
  - Fixed Deposits maintained with a scheduled commercial bank with a lien marked in favour of the RE
  - Bank Guarantee in favour of the RE
- The RE shall ensure that the total amount of default loss guarantee shall not exceed 5% of the amount of that loan portfolio. Similarly, even in case of implicit guarantee arrangements, the DLG Provider shall not bear performance risk of more than the equivalent amount of 5% of the underlying loan portfolio.
- The RE shall invoke DLG within a maximum overdue period of 120 days, unless made good by the borrower before that.
- The responsibility of recognition of individual loan assets in the portfolio as NPA and consequent provisioning will be of the RE. The amount of DLG invoked shall not be set off against the underlying individual loans.
- RE and the Lending Service Provider (LSP) have to comply with due diligence and other requirements with respect to DLG arrangement. Banks and NBFCs must put in place a Board approved policy before entering into any DLG agreement. Further, a robust credit underwriting standards should be put in place irrespective of the DLG cover.
- The LSP must disclose the total number of portfolios and the DLG arrangements on their websites.

How we see it:

The guidelines bring back an additional layer of security, which is essential for regulated entities to maintain and enhance financial stability while venturing into new lending markets. It also brings significant relief to the LSP and will continue to play a significant role in extending credit to the underserved. However, the regulated entities will need to adhere to the following:

1. Review the existing arrangements and ensure that they are compliant with the guidelines.
2. Review their expected credit loss models in lieu of the new guidelines.
3. Provide for losses on account of default loss guarantees to the RE, based on the Ind AS requirements.
4. Extensive disclosures as required by the RBI guidelines and Ind AS will be required to be given in the financial statements.
5. Certification by auditor of the aggregate DLG outstanding, aimed at ensuring greater transparency and instilling RE confidence. However, auditors will have to be vigilant in identifying any other implicit guarantee of similar nature linked to the performance of the loan portfolio.

02

Reserve Bank of India (Financial Statements - Presentation and Disclosures) Directions, 2021: Presentation of unclaimed liabilities transferred to Depositor Education and Awareness (DEA) Fund

Effective date: 31 March 2024

Applicability- All Commercial Banks

Reserve Bank of India (Financial Statements - Presentation and Disclosures) Directions, 2021 (Master directions) mandate commercial and co-operative banks to present unclaimed liabilities where amount due is transferred to the Depositor Education and Awareness (DEA) Fund under 'Schedule –12 - Contingent Liabilities- Other items for which the bank is contingently liable.' To align financial reporting practices with those of commercial banks, all co-operative banks are advised by RBI vide circular dated 25 October 2023, to present all unclaimed liabilities, transferred to the DEA Fund, under 'Contingent Liabilities – Others'.

Additionally, all banks must disclose in financial statements notes that balances of the amount transferred to the DEA Fund are included under 'Schedule –12 - Contingent Liabilities - Other items for which the bank is contingently liable' or 'Contingent Liabilities – Others' as the case may be.

How we see it:

RBI aims to promote uniformity in financial statement presentation across commercial banks and cooperative banks by recommending consistent treatment and disclosure in the notes to accounts for unclaimed liabilities amounts transferred to the DEA Fund.

03

Implementation of Indian Accounting Standards (Ind AS): Asset Reconstruction Companies (ARC)

Effective date: 20 February 2023

Applicability- Asset Reconstruction Companies

RBI observed that consequent to the implementation of Ind AS, some ARCs have been recognizing management fees even if they have not been realized for over 180 days. To address this issue, the RBI has issued guidelines for ARCs preparing their financial statements as per Ind AS. The circular addresses concern arising from the recognition of management fees that remain unrealised for an extended period, emphasizing prudential measures to safeguard the financial stability of ARCs.

Identification of unrealised management fees

To address the prudential concerns arising from continued recognition of unrealised income, ARCs preparing their financial statements under Ind AS are mandated to deduct specific amounts from their net owned funds when calculating the capital adequacy ratio and the amount available for dividend payments. These deductions encompass:

- Management fees recognised during the planning period but unrealised beyond 180 days from the date of expiry of the planning period.
- Management fees recognised after the expiry of the planning period, remaining unrealised beyond 180 days of such recognition.
- Unrealised management fees, irrespective of the duration, when the net asset value of security receipts falls below 50% of the face value.

This reduction impacts the calculation of the Capital Adequacy Ratio and the amount available for dividend payments. The reduction shall be the net of specific expected credit loss allowances held on such unrealised management fee and any associated tax implications.

Role of audit committee

The Audit Committee of the Board (ACB) plays a pivotal role in reviewing the extent of unrealised management fees. The ACB must ensure the recoverability of such fees while finalising the financial statements. Stringent compliance with existing regulations for computing management fees is mandated.

Disclosure requirements

ARCs are obligated to disclose detailed information on the ageing of unrealised management fees in their annual financial statements. The format includes the outstanding amounts, allowances held, and the net unrealised management fees receivable, and ageing of other unrealised amounts as provided below:

Particulars	As at the end of Current Year	As at the end of Previous Year
Outstanding amount of unrealised management fee		
Out of the above, amount outstanding for:		
1. Amounts where the net asset value of the security receipts has fallen below 50 per cent of the face value		
2. Other amounts unrealised for:		
‣ More than 180 days but up to 1 year		
‣ More than 1 year but up to 3 years		
‣ More than 3 years		
Allowances held for unrealised management fee		
Net unrealised management fee receivable		

How we see it:

This circular aims to address concerns stemming from the recognition of unrealised management fees by ARCs under Ind AS and emphasizing the critical need to diligently evaluate the recoverability of management fees. By reducing such fees from net owned funds and incorporating stringent disclosure requirements, the RBI intends to enhance transparency and financial stability in the sector. The circular emphasizes the need to assess management fees recoverability carefully. This promotes responsible financial practices in ARCs.

04

Master Direction: Classification, Valuation and Operation of Investment Portfolio of Commercial Banks (Directions), 2023

Effective date: 01 April 2024

Applicability- All commercial banks (excluding regional rural banks)

In view of significant changes in global standards and the linkages with the capital adequacy framework, there was a dire need to change the existing investment classification, accounting, and valuation norms in India. Accordingly, the Reserve Bank of India (RBI) has issued Classification, Valuation and Operation of Investment Portfolio of Commercial Banks, Directions, 2023 (referred to as "the directions") which will be applicable to all Commercial Banks in India from 01 April 2024.

Key proposals and considerations as per the directions

1 Classification

- Investments will now be classified based on the business model and results of Solely Payments of Principal and Interest (SPPI) as against extant guidelines of rule-based classification. Revised classification of investments is Held to Maturity (HTM), Available for Sale (AFS) and Fair value through P&L (FVTPL), Held for trading will be a sub-category within FVTPL .
- Any security that now meets the above-mentioned criteria can be classified as HTM as against the current practice of classifying only SLR securities and certain defined non-SLR securities. The overall limit of holding 25% of total investment as HTM is now dispensed. Also, the ceiling criteria for holding HFT securities for 90 days are removed.
- All Investments in own subsidiaries, joint ventures and associates would be held in a distinct category, which is separate from other investment categories (i.e., HTM, AFS and FVTPL) as against the extant practice of classifying the same as HTM.

2 Reclassification

- Subsequent to transition, banks shall not reclassify investments between categories without the approval of their board and Department of Supervision (DoS), RBI, as against the extant practice of reclassification of portfolio once every year.
- Permission for reclassification would be given in rare circumstances, wherein the bank could demonstrate that such reclassification is necessitated by a significant change in the way in which it proposes to manage a group of investments.
- The reclassification should be applied prospectively from the reclassification date and the bank shall disclose details of such reclassification, including reclassification adjustments, in the notes of the financial statements.

Classification

HTM

- the financial assets are held with an objective to collect the contractual cash flows
- solely payments of principal and interest (SPPI Criterion) on principal outstanding

AFS

- the financial assets are held with an objective to collect the contractual cash flows and selling them
- solely payments of principal and interest on principal outstanding

FVTPL

FVTPL is a residual category. All investments that do not qualify for inclusion in HTM or AFS shall be categorised as FVTPL

HFT

Banks shall create a separate sub-category called HFT within FVTPL. The directions provide for specific inclusion and exclusion of securities/instruments that can be categorized under HFT category

How we see it:

The banks will be required to ascertain the optimal composition of investment portfolio considering restrictions on portfolio transfers, reclassification, and overall impact on CET 1 capital. The banks may have an impact on portfolio performance as reclassification of portfolio is now restricted and allowed only in exceptional circumstances, with prior approvals. Therefore, the Banks will have to be cautious while determining the portfolio classification on the date of transition. These provisions of reclassification are similar to that mentioned in Ind AS 109 /IFRS 9, where in reclassification is allowed only when an entity changes its business model.

3 Initial recognition

All investments now shall be measured at fair value on initial recognition. The RBI has clarified in FAQs that unless facts and circumstances suggest that the fair value of investments is materially different from its acquisition cost, it shall be presumed that at initial recognition, the acquisition cost is the fair value. A day one gain or loss could arise on initial recognition if there is a difference between the fair value and the acquisition cost of an investment. Such a gain or loss would be accounted for differently, depending on whether the fair value is based on market observable inputs.

4 Subsequent measurement

- **HTM** - The securities held under HTM should be **carried at cost** and not be Marked to Market (MTM) after initial recognition. Any discount or premium on securities under HTM should be amortised over the remaining life of the instrument.
- **AFS** - The securities held under AFS shall be **fair valued** at least on a quarterly basis. The valuation gains and losses held under AFS (across all performing investments, irrespective of their classification) need to be aggregated and the net appreciation or depreciation should directly get credited or debited to a reserve named 'AFS reserve' without routing through the profit and loss account. Any discount or premium on the acquisition of debt securities under AFS needs to be amortised over the remaining life of the instrument. Upon sale or maturity of a debt instrument classified under AFS, the accumulated gain/loss in the AFS reserve should be transferred and recognized in the profit and loss account. However, in case of any equity instrument classified under AFS, any gain or loss on sale should be transferred to the capital reserve.
- **FVTPL** - The securities held under FVTPL must be **fair valued** and the net gain or loss arising on such valuation should be directly credited or debited to the Profit and Loss Account. Securities that are classified under the HFT sub-category within FVTPL should be fair valued on a daily basis, whereas other securities in FVTPL need to be fair valued at least on a quarterly basis, if not more frequently. Any discount or premium on the acquisition of debt securities under FVTPL should be amortised over the remaining life of the instrument.

- **Investments in subsidiaries, associates and joint ventures** - All investments in subsidiaries, associates and joint ventures should be held at **acquisition cost**. Any discount or premium on the acquisition of debt securities of subsidiaries, associates and joint ventures must be amortised over the remaining life of the instrument. The guidelines also stipulate the valuation of investments when an investee subsequently becomes a subsidiary, associate, or a joint venture, or when an investee ceases to be a subsidiary, associate, or a joint venture. The gain/profit on reclassification/sale of an investment in a subsidiary, associate or joint venture should first be recognised in the Profit and Loss Account and then appropriated below the line to the Capital Reserve Account. Investments in subsidiaries, associates and joint ventures should be assessed for impairment at least on a quarterly basis. When there are indicators of impairment, banks should obtain an investment valuation certificate from an independent valuer. The provision for impairment should be provided and reversed through the profit and loss account.

How we see it:

Banks' investment portfolio, classified as AFS and FVTPL, will be carried at fair value as against the extant practice, enabling more transparency to the users of the financial statements. Even though the measurement requirements are aligned to Ind AS/IFRS requirements, the circular is silent on amortisation of transaction cost (incurred for acquisition of the investments) therefore it seems the direction has not implemented Effective Interest Rate (EIR).

5 Valuation

RBI has introduced fair value definition as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date, i.e., exit price.

- The RBI Master Directions provide guidance on how fair value shall be determined for quoted securities, unquoted SLR securities and unquoted non-SLR securities (Refer below table).
- To increase consistency and comparability in fair value measurements and related disclosures, Banks shall categorize its investment portfolio into three fair value hierarchies i.e., Level 1, Level 2, and Level 3, the disclosure template for which is provided in Annex II of the Directions.
- Banks shall not pay dividends out of net unrealised gains recognised in the profit and loss account arising on fair valuation of Level 3 investments on their balance sheet. Further, such net unrealised gains on Level 3 investments recognised in the profit and loss account or in the AFS-Reserve shall be deducted from Common Equity Tier (CET) 1 capital. Provided that this clause shall not apply to investments that meet the Solely Payment of Principal and Interest (SPPI) criteria and are required to be risk weighted at 50 per cent or lower for credit risk as per applicable regulatory instructions on capital adequacy.

Type of security	Valuation methodology
Quoted securities	FBIL, FIMMDA
Unquoted SLR securities	► Treasury bills at carrying cost. ► Unquoted central / state government securities - FBIL ► Other approved securities - YTM method
Unquoted non-SLR securities	► Unquoted debentures and bonds - as per YTM rates by FBIL/FIMMDA ► UDAY and DISCOM bonds - prices/yields published by FBIL. ► State government-guaranteed bonds - YTM rates for central government securities of equivalent maturities as published by FBIL
Zero coupon bonds (ZCBs)	In the absence of market value, the ZCBs shall be marked to market with reference to the present value
Preference shares	As per market rates, if quoted, or on appropriate yield to maturity basis not exceeding redemption value as per FBIL guidelines
Equity shares	As per market rates, if quoted, otherwise at break-up value
Mutual funds (MF)	As per stock exchange quotations, if quoted. In case of unquoted units, as per the latest repurchase price declared by concerned MF. In cases where the latest repurchase price is not available, as per Net Asset Value (NAV)
Commercial paper	Carrying cost
Investment in alternative Investment funds (AIFs)	► Quoted equity shares, bonds, units of AIFs in the bank's portfolio shall be valued mutatis mutandis as per instructions given in these directions for quoted securities. ► Unquoted instruments of AIFs shall be valued at NAV (units) and for other instruments, shall be as per the methodology specified for such instruments above

6 Derivatives

- Banks shall comply with the requirements of the Guidance Note on Accounting for derivative Contracts (revised 2021) issued by ICAI, except sections pertaining to current and non-current classification.
- Banks shall present their derivative asset and liabilities as separate line items under Schedule 11: 'Other Assets' and Schedule 5:'Other Liabilities' respectively and may make adjustments to the carrying value of their investments in compliance with the hedge accounting requirements of the said Guidance Note.
- Bank shall categorize their derivatives portfolio into three fair value hierarchies viz., Level 1, Level 2, and Level 3 and disclose the same in the notes to accounts.
- Banks shall not pay dividends out of net unrealised gains recognised in the Profit and Loss Account arising on fair valuation of Level 3 derivatives assets and liabilities on their Balance Sheet. Further, such net unrealised gains shall be deducted from CET 1 capital.

7 Income recognition, asset classification and provisioning

▶ **Non-performing investment**

1. Banks shall be required to use Prudential Norms on Income Recognition, Asset Classification and Provisioning (IRACP) norms for classify an investment as a Non-Performing Investment (NPI)

    - Debt instruments, preference share with fixed dividend will be tagged as NPI where interest/ instalment is due and remains unpaid for more than 90 days.
    - Preference shares where dividend (cumulative or non-cumulative) is not declared / paid in any year it shall be treated as due / unpaid in arrears and the date of balance sheet of the issuer for that particular year shall be reckoned as due date for the purpose of asset classification. Such an investment can be upgraded subsequently on payment of dividend for the current period in the case of non-cumulative preference shares and payment of dividend in arrears and for current period in the case of cumulative preferences shares.
    - In the case of equity shares, in the event the investment in the shares of any company is valued at INR1 per company on account of the non-availability of the latest balance sheet, those equity shares shall be reckoned as NPI. The NPI can be upgraded subsequently on receipt of the audited balance sheet.
    - If any credit facility availed by the issuer is NPA in the books of the bank, investment in any of the securities, including preference shares issued by the same issuer, shall also be treated as NPI and vice versa.
    - In case of conversion of principal and / or interest into equity, debentures, bonds, etc., such instruments shall be classified in the same asset classification category as the loan and provision shall be made as per the norms.

2. Irrespective of the category (i.e., HTM, AFS or FVTPL (including HFT)) in which the investment has been placed, the expense for the provision for impairment shall always be recognised in the Profit and Loss Account.
3. Once an investment is classified as an NPI, it should be segregated from the rest of the portfolio and not considered for netting valuation gains and losses.
4. Banks shall not accrue any income on NPIs. Income shall be recognised only on realisation of the same . Further, any MTM appreciation in the security shall be ignored.
5. Upon an account being upgraded as per IRACP norms, any provision previously recognised shall be reversed, and symmetric recognition of MTM gains and losses can resume.
6. Investments in central government securities and state government securities shall not be classified as NPI.
7. The provision to be held on an NPI shall be the higher of the following amounts:

    - The amount of provision required as per IRACP norms before it was classified as NPI.
    - The depreciation on the investment with reference to its carrying value on the date of classification as NPI

How we see it:

The directions still require NPI to be measured as per IRACP norms.

The RBI released a Discussion paper on Expected Credit Loss (ECL) in January 2023, which required ECL to be applied on investments classified as HTM and AFS. Once the final guidelines on ECL are released, it is expected that the master directions on Investments may undergo.

- **Investment Fluctuation Reserve (IFR)**

1. Banks shall create an Investment Fluctuation Reserve (IFR) until the amount of IFR is at least 2% of the AFS and FVTPL (including HFT) portfolio, on a continuing basis, by transferring to the IFR an amount not less than the lower of the following:
    - Net profit on sale of investments during the year.
    - Net profit for the year, less mandatory appropriations.
2. Banks shall be permitted to draw down the balance available in IFR in excess of 2% of its AFS and FVTPL

How we see it:

There is no such concept of IFR under Ind AS/IFRS which is to be maintained at 2% of the AFS and FVTPL.

- **Increased governance:**

Extensive reporting requirements have been introduced to enable better oversight and monitoring of commercial banks' investment activities. Implementation of these Directions shall be reviewed under the supervisory process and any non-compliance in this regard shall be dealt with appropriately by RBI. Extensive disclosure requirements have been set out in the master direction to ensure better transparency to the users. For e.g., the disclosure of the valuation methods would ease certain regulatory concerns with regard to the valuation of securities, which is not based on market inputs (for instance, in case of unquoted equity shares. Most of these disclosures are required to be made in the financial statements for the year ending 31 March 2025.

How we see it:

With the said circular, banks will have to gear up the implementation of systems, update its existing policies and processes to ensure compliance with the guidelines by April 2024.

To summarize, while retaining concepts of prudence and conservatism, the Master Direction is a major step towards convergence of investment accounting norms for banks under Indian GAAP with global standards.

Transition and repeal provisions

At the time of transition to these directions (i.e., on 01 April 2024), banks shall re-classify their investment portfolio as of 31 March 2024, as per the RBI Directions. The balance in provision for depreciation, as of 31 March 2024, shall be reversed into the Revenue/ General Reserve. The balances in Investment Reserve Account (IRA), if any, as of 31 March 2024, shall be transferred to the Revenue/ General Reserve if the bank meets the minimum regulatory requirements of IFR. If the bank does not meet the minimum IFR requirements, the balances in IRA shall be transferred to IFR. The specific treatment for transition from the previous to the revised framework is given in detail in the RBI Master Circular.

Previous framework	Revised framework	Opening accounting adjustments as on 01 April 2024
HTM	HTM	▶ The acquisition cost adjusted for any premium/ discount amortised between the date of acquisition and 31 March 2024 shall be the revised carrying value. ▶ The difference between the revised carrying value and the previous carrying value shall be adjusted in any revenue/general reserve.
	AFS	▶ The fair value as of 31 March 2024 shall be the revised carrying value. ▶ The difference between the revised carrying value and the previous carrying value shall be adjusted in AFS-Reserve.
	FVTPL	▶ The fair value as of 31 March 2024, shall be the revised carrying value. ▶ The difference between the revised carrying value and the previous carrying value shall be adjusted in any revenue/ general reserves.
AFS	HTM	▶ The acquisition cost adjusted for any premium/ discount amortised between the date of acquisition and 31 March 2024 shall be the revised carrying value. ▶ The difference between the revised carrying value and the previous carrying value shall be adjusted in revenue/ general reserves.
	AFS	▶ The fair value of the investment as of 31 March 2024, shall be the revised carrying value. ▶ The difference between the revised carrying value and the previous carrying value shall be adjusted in AFS- Reserve.
	FVTPL	▶ The fair value as of 31 March 2024 shall be the revised carrying value. ▶ The difference between the revised carrying value and the previous carrying value shall be adjusted in any revenue/ general reserves.
HFT	HTM	▶ The acquisition cost adjusted for any premium/ discount amortised between the date of acquisition and 31 March 2024 shall be the revised carrying value. ▶ The difference between the revised carrying value and the previous carrying value shall be adjusted in revenue/ general reserves.
	AFS	▶ The fair value as of 31 March 2024, shall be the revised carrying value. ▶ The difference between the revised carrying value and the previous carrying value shall be adjusted in AFS- Reserve.
	FVTPL	▶ The fair value as of 31 March 2024, shall be the revised carrying value. ▶ The difference between the revised carrying value and the previous carrying value shall be adjusted in any revenue/ general reserves.

Disclosure

The guidelines issued by RBI have outlined certain extensive disclosure requirements for the investment portfolio of a bank. The details of the investment portfolio shall be disclosed in notes to accounts of the bank's financial statements as per templates specified in the guidelines. These disclosure requirements shall become effective from the audited financial statements for the financial year ending 31 March 2026 onwards.

Details of certain of these key disclosures are:

- Some disclosures require details such as carrying value, fair value, etc., for each fair value hierarchy of the Investment portfolio (Level 1, Level 2, and Level 3) and across Investment classification categories (HTM, AFS, FVTPL, etc.) separately for Investments in India and Investments outside India.
- For Derivative Investments, details such as MTM-Assets, MTM Liabilities, realised gain/loss on derivatives, etc., are required to be categorised in fair value hierarchy of the Investment Portfolio.
- Banks are also required to disclose recognised net gain or (losses) on Level 3 financial instruments and details of sales made out of HTM instruments.

Banks shall make suitable disclosures of the transitional adjustment made in their notes to the financial statements for the financial year ending 31 March 2025, however additional clarification and guidance is awaited from RBI regarding the exact nature and requirement of transition related disclosures to be presented in the financial statements.

These disclosures aim to improve the quality of a bank's financial reporting and strengthen the overall risk management framework of the Banks.

05

Framework for compromise settlements and technical write-offs

Effective date: 08 June 2023

Applicability-

- Commercial Banks (including Small Finance Banks, Local Area Banks, and Regional Rural Banks)
- Primary (Urban) Co-operative Banks/State Co-operative Banks/ Central Co-operative Banks
- All-India Financial Institutions
- NBFCs (including HFCs)

RBI has issued a framework for compromise settlements and technical write-offs for operationalising compromise settlements in respect of stressed accounts to all regulated entities (REs).

The RBI has issued various instructions to REs regarding compromise settlements in respect of stressed accounts from time to time, including the Prudential Framework for Resolution of Stressed Assets dated 07 June 2019 ("Prudential Framework"), which recognises compromise settlements as a valid resolution plan. With a view to provide further impetus to resolution of stressed assets in the system as well as to rationalise and harmonise the instructions across all REs, as announced in the Statement on Developmental and Regulatory Policies released on 08 June 2023, it has been decided to issue a comprehensive regulatory framework governing compromise settlements and technical write-offs covering all the REs.

Compromise settlement for this purpose shall refer to any negotiated arrangement with the borrower to fully settle the claims of the RE against the borrower in cash; it may entail some sacrifice of the amount due from the borrower on the part of the REs with the corresponding waiver of claims of the RE against the borrower to that extent.

Technical write-off for this purpose shall refer to cases where the non-performing assets remain outstanding at borrowers' loan account level but are written-off (fully or partially) by the RE only for accounting purposes, without involving any waiver of claims against the borrower, and without prejudice to the recovery of the same.

1 Board approved policy

- REs shall put in place Board-approved policies for undertaking compromise settlements with the borrowers as well as for technical write-offs.
- The policy shall consist of necessary conditions precedent such as minimum ageing, deterioration in collateral value etc. and have a graded framework for examination of staff accountability in such cases with reasonable thresholds and timelines.
- The policy will contain provisions relating to arrival at the settlement amount as well as methodology for arriving at the realisable value of the security. The objective shall be to maximise the possible recovery from a distressed borrower at minimum expense, in the best interest of the RE.

2 Delegation of power

- The policy should also mention delegation of power for approval or sanction of compromise settlements and technical write off.
- For compromise settlements, the authority shall consist of authority at least one level higher in hierarchy than the authority vested with the power to sanction the credit / investment exposure. Provided that any official who was part of sanctioning the loan (as individual or part of a committee) shall not be part of the approving the proposal for compromise settlement of the same loan account, in any capacity.
- Additionally, board approval shall be required for compromise settlements in respect of debtors classified as fraud or wilful defaulter.

3 Prudential treatment

- Compromise settlements where the time for payment of the agreed settlement amount exceeds three months shall be treated as restructuring.
- In case of partial technical write-offs, the prudential requirements in respect of residual exposure, including provisioning and asset classification, shall be with reference to the original exposure.

4 Reporting mechanism

There shall be a reporting mechanism to the next higher authority, at least on a quarterly basis, with respect to compromise settlements and technical write offs approved by a particular authority. Compromise settlements and technical write-offs approved by the MD and CEO / Board Level Committee would be reported to the Board.

5 Cooling period

Cooling period is to be determined by the respective Board approved policies. Provided that:

- The cooling period in respect of exposures other than farm credit exposures shall be subject to a floor of 12 months. REs are free to stipulate higher cooling periods in terms of their Board approved policies.
- The cooling period for farm credit exposures shall be determined by the REs as per their respective Board approved policies.

6 Treatment of accounts categorized as fraud and wilful defaulter

REs may undertake compromise settlements or technical write-offs in respect of accounts categorised as wilful defaulters or fraud without prejudice to the criminal proceeding underway against such debtors.

7 Reporting format to ensure coverage

The Board of the REs is required to ensure a suitable reporting format is in place to ensure adequate coverage of the following aspects at the minimum:

1. trend in number of accounts and amounts subjected to compromise settlement and/or technical write-off.
2. out of (1) above, separate breakup of accounts classified as fraud, red-flagged, wilful default, and quick mortality accounts.
3. amount-wise, sanctioning authority-wise, and business segment / asset-class wise grouping of such accounts.
4. extent of recovery in technically written-off accounts.

How we see it:

1. Issuance of this framework by RBI has not only streamlined the instructions regarding compromise settlements and technical write-offs but has also liberalized the regulation to some extent by allowing fraud cases/wilful defaulters to participate in this process.
2. It is essential to understand the difference and economic rationale between restructuring, compromise settlement and technical write-off, as accounting treatment would significantly differ for each of the above under Indian GAAP and Ind AS.
3. Technical write-off would result in a write-off amount to be expensed immediately in the statement of profit and loss after adjusting any existing provision. Technical write off may be full or partial and hence to the extent it is not full the loan will continue in the financial statements of the company. In case of Compromise settlement, it would result in derecognition of loan, whereas in case of restructuring the modification and derecognition principles under Ind AS may have to be evaluated and accordingly the impact on Expected Credit Loss (ECL) provisioning for these loans may be adjusted.

06

Investment in Alternative Investment Fund ("AIF")

Effective date: 19 December 2023

Applicability-

- All commercial banks (including small finance banks, local area banks, and regional rural banks)
- All primary (urban) co-operative banks/state co-operative banks/ central co-operative banks
- All India Financial Institutions
- All NBFCs (including HFCs)

Since several Regulated Entities (REs) have affiliated AIFs, routing the money through AIFs to borrowers might have led to evergreening. That is, the AIF would invest the money into a debtor company, and consequently, the debtor company would keep its account as a performing asset. In order to address concerns relating to possible evergreening through this route, below has been notified by RBI:

Restrictions on investment in debtor company by AIF

- REs shall not make investments in any scheme of AIFs which has downstream investments either directly or indirectly in a debtor company of the RE.
  - Debtor Company is defined as "company to which the RE currently has or previously had a loan or investment exposure anytime during the preceding 12 months."
- Rectifications steps to be followed by the RE in case of investments in AIF with downstream investment in debtor company:
  - New Investment – liquidate within 30 days of the investment.
  - Existing investment – liquidate within 30 days of the circular date.
  - Unable to liquidate within 30 days – make 100% provision on such investments.

Restrictions by AIF scheme with 'priority distribution model'

- Any investment by REs in the subordinated units of any AIF scheme with a 'priority distribution model' shall be subject to full deduction from RE's capital funds, i.e., from "Equity Contribution of owners."
  - Priority Distribution Model is when one class of investors (other than sponsor/manager) share loss more than pro rata to their holding in the AIF, since the latter has priority in distribution over former.

How we see it:

The RBI has imposed a restriction on investment in AIF by RE to ensure restriction on evergreening / revolving of debtors. REs may consider building an adequate risk control policy to ensure compliance with the circular. RE may review and update its existing investment policy adhere to the prescribed guidelines of the circular.

* Further to the above circular RBI has issued recent clarification dated 27 March 2024 - To ensure uniformity in implementation among the REs, and to address the concerns flagged in various representations received from stakeholders

07

Framework for acceptance of green deposits

Effective date: 01 June 2023

Applicability- Below Regulated Entity (RE):

- All scheduled commercial banks, including small finance banks and excluding:
  1. Regional rural banks
  2. Local area banks
  3. Payments banks
- All deposit taking Non-Banking Finance Companies (NBFCs) including Housing Finance Companies (HFCs)

Introduction

In today's rapidly evolving financial landscape, **green deposits** are emerging as an important tool for promoting sustainable and environmentally friendly practices. These are a specific type of deposit accepted by RE that earns interest over a specified period and the proceeds of which are earmarked for being allocated towards green finance. As global concerns over climate change and environmental conservation grow, both institutions and individuals are becoming more aware of their potential impact on the world. This sentiment is increasingly extending to their choices in banking and investments, leading to a demand for more sustainable financial products.

Reserve Bank of India (RBI) through its circular dated 11 April 2023 on "Framework for the acceptance of Green deposit" (the framework) aims to provide a comprehensive understanding of what green deposits are, how they protect interest of the depositors, aid customers in achieving their sustainability agenda, address greenwashing concerns and help in expanding the flow of credit to green activities/ projects.

Embracing green deposits as a part of their financial product suite allows RE to position themselves at the forefront of the movement towards sustainable banking, opening up new opportunities for growth and market differentiation. This framework seeks to be a guide for RE on their journey towards sustainability, while also serving as an illuminating piece for anyone interested in the intersection of finance and sustainability.

An overview of the circular

- REs are required to implement a comprehensive, Board-approved policy for initiating and managing green deposits. This involves the creation of a Financing Framework (FF) that details all aspects of green deposit allocation – from outlining eligible green activities/ projects for investment, to evaluation, selection, and monitoring processes. The temporary allocation of the green deposit funds, which would be invested in liquid assets for up to maximum original tenure of one year, is also included in the FF.
- The allocation of proceeds will be based on the official Indian green taxonomy. Until this taxonomy is finalized, green deposits will be used for initiatives that encourage resource efficiency, reduce carbon emissions, promote climate resilience, and improve natural ecosystems. Framework outlines a certain sector along with the description in which the proceeds may or may not be used.
- These green allocations would have to undergo annual third-party verification to ensure that the proceeds are being used as intended. Additionally, the REs are required, with the help of external firms, to assess the environmental impact of the green finance projects on an annual basis. Initially, this impact assessment would be voluntary but would become mandatory starting from the fiscal year 2024-25.
- Within three months of the end of each fiscal year, REs will present a review report to their Board of Directors detailing the amounts raised, the allocation of the funds to green projects, and copies of the third-party verification and impact assessment reports. They are also required to disclose information about the usage of the green deposit funds in their annual financial statements.

Key points to be taken care of by the REs

- Create and make available to the public an elaborate, board-approved policy detailing all aspects of the issuance and allocation of green deposits.
- Develop a board-approved financing framework for effective allocation of green deposits, covering eligible activities/projects, evaluation and selection process, allocation and reporting of proceeds, and details about temporary allocation of green deposit proceeds.
- Implement an independent third-party verification/ assurance of the allocation of funds raised through green deposits annually.
- Ensure use of proceeds aligns with eligible green activities/projects and maintain necessary monitoring systems to track end-use of funds allocated through green deposits.
- Assist external firms to annually assess the impact of the funds lent for green finance activities/projects through an impact assessment report.
- Generate and present a review report to the board covering the amount raised under green deposits, list of funded green activities/projects, amounts allocated and copies of the third-party verification/assurance report, and the impact assessment report.
- Make necessary disclosures in their annual financial statements on the portfolio-level information regarding the use of the green deposit funds as per the specified proforma.

How we see it:

1. This framework on green deposit aims to minimize the concerns relating to greenwashing by increasing compliance and mandating entities to build a robust policy for monitoring the utilization of the green deposits.
2. Entities need to consider the efforts required for implementing a board approved policy with respect to green deposit and cost to be incurred by an independent third party for annual impact assessment of the funds let for or invested, enhanced monitoring systems and environmental impact assessment.
3. Entities to assess the impact on liquidity ratios by strategically positioning these deposits and optimizing the benefits of green deposit initiatives.
4. Even though many entities have already issued green deposits, there is still a need for creating awareness to a larger audience, external as well as within the entity, by building a strategy and investing in skill set development and education.
5. Entities may, however, await the clarification on guidance regarding the nature of assurance required and assurance standards which need to be complied along with transitional provisions for existing green deposits offered by the entities before the framework was effective i.e., 01 June 2023.

B

Other Regulatory changes

1. Streamlining of Internal Compliance monitoring function – leveraging use of technology
2. Fair Lending Practice - Penal Charges in Loan Accounts
3. Reserve Bank of India (Call, Notice and Term Money Markets) Directions, 2021-Review
4. Regulatory measures towards consumer credit and bank credit to NBFCs
5. Display of information – Secured assets possessed under the SARFAESI Act, 2002
6. RBI's Revised Guidelines on Inoperative Accounts and Unclaimed Deposits: Streamlining Banking Practices for Enhanced Compliance
7. Appointment of Whole-Time Director(s)
8. Responsible Lending Conduct - Release of Movable / Immovable Property Documents on Repayment/ Settlement of Personal Loans
9. Master Direction on Information Technology Governance, Risk, Controls and Assurance Practices
10. Master Direction on Outsourcing of Information Technology Services
11. Reset of Floating Interest Rate on Equated Monthly Instalments (EMI) based Personal Loans
12. Classification of MSMEs

01

Streamlining of Internal Compliance monitoring function: Leveraging the use of technology

Effective date: 31 January 2024

Applicability-

- Scheduled Commercial Banks (with the exception of Regional Rural Banks), Small Finance Banks, Payments Banks, Primary (Urban) Co-operative Banks (Tier III and IV)
- Upper- and Middle-Layer Non-Banking Financial Companies (including Housing Finance Companies)
- Credit Information Companies
- All India Financial Institutions (EXIM Bank, National Bank for Agriculture and Rural Development (NABARD), National Bank for Financing Infrastructure and Development (NaBFID), National Housing Bank (NHB), and Small Industries Development Bank of India (SIDBI)).

RBI vide its circular intends to streamline the internal compliance monitoring function by leveraging the use of technology. The REs, in general, adopts varying levels of automation, ranging from macro-enabled spreadsheets to workflow-based software solutions. However, there are still significant manual interventions in the function that is being carried out. Thus, there was a need to implement comprehensive, integrated, enterprise-wide and workflow-based solutions/ tools to enhance the effectiveness of this function.

As per the circular, the necessary changes to existing systems or implementation of new systems should be carried out latest by 30 June 2024.

How we see it:

The circular would require the REs to explore and select comprehensive, integrated, enterprise-wide, and workflow-based solutions or tools that can enhance the effectiveness of compliance monitoring, which should, among other things, provide for essentials listed below.

1. Effective communication and collaboration among all the stakeholders (by bringing business, compliance and IT teams, Senior Management, etc. on one platform) since an integrated platform can serve as the nerve center for this cross-functional collaboration.
2. The chosen solution should encompass mechanisms for identifying, assessing, monitoring, and managing compliance obligations. Moreover, it should have a structured process for escalating non-compliance issues.
3. It must include features for logging approvals from competent authorities regarding deviations or delays in compliance submissions, ensuring accountability and traceability.
4. Unified Dashboard for Senior Management offering a comprehensive view of the compliance status across the entity.
5. Tailor the dashboard based on the size and complexity of the RE's operations.

Further, REs are requested to put an appropriate monitoring mechanism also in place to review the progress of implementation of automation of compliance monitoring process.

02

Fair lending practice: Penal charges in loan accounts

Effective date: 18 August 2023

Applicability-

- All commercial banks (including small finance banks, local area banks, and regional rural banks, excluding payments banks).
- Primary (urban) co-operative banks
- NBFCs (including HFCs).
- All India Financial Institutions (EXIM Bank, NABARD, NHB, SIDBI and NaBID)

Exclusions-

- Credit cards,
- External commercial borrowings,
- Trade credits and
- Structured obligations which are covered under product specific directions by RBI.

According to the RBI, operational autonomy is given to lending institutions to set their policies for imposing penal interest rates. However, the purpose of this charge is to reinforce discipline in credit usage and not to be utilized as a tool for boosting revenue.

RBI observed that the various practices adopted by financial institutions in levying penal interest have led to disputes and customer complaints. Therefore, the central bank has issued the following instructions:

- Penal charges should not be levied in the form of 'penal interest' added to the rate of interest charged on advances. There should be no capitalization of penal charges, meaning no further interest should be computed on such charges. However, this does not affect the normal procedures for compounding of interest in the loan account.
- Financial institutions should formulate a Board-approved policy on penal charges or similar charges on loans.
- The quantum of penal charges should be reasonable and commensurate with the non-compliance of material terms and conditions of the loan contract. They should not be discriminatory within a particular loan/product category.
- Penal charges for loans sanctioned to 'individual borrowers, for purposes other than business,' should not be higher than the penal charges applicable to non-individual borrowers for similar non-compliance of material terms and conditions.
- The quantum and reason for penal charges should be clearly disclosed by financial institutions to the customers in the loan agreement and most important terms and conditions / Key Fact Statement (KFS), in addition to being displayed on financial institution's website under interest rates and service charges.
- Whenever reminders for non-compliance of material terms and conditions of loan are sent to borrowers, the applicable penal charges should be communicated. Further, any instance of levy of penal charges and the reason therefore should also be communicated.
- These instructions will come into effect from 01 January 2024. Financial institutions may carry out appropriate revisions in their policy framework and ensure implementation of the instructions in respect of all the fresh loans availed/ renewed from the effective date. In the case of existing loans, the switchover to new penal charges regime should be ensured on the next review or renewal date or six months from the effective date of these instructions, whichever is earlier.

These instructions do not apply to credit cards, external commercial borrowings, trade credits, or structured obligations, which are covered under product-specific directions.

How we see it:

Financial institutions need to review and possibly revise their current policies and practices regarding penal charges. They need to ensure transparency and fairness in the application of these charges, and to communicate clearly with customers about any penalties that may apply to their loans. The requirement for a Board-approved policy on penal charges by regulators suggests a need for accountability and oversight from financial institutions in the setting and application of these charges. The guidelines also imply a future regulatory focus on this area, with potential consequences for non-compliance.

* Further to the above circular RBI has issued recent clarification dated 29 December 2023 - Fair Lending Practice - Penal Charges in Loan Accounts: Extension of Timeline for Implementation of Instructions

03

Reserve Bank of India (Call, Notice and Term Money Markets) Directions, 2021-Review

Effective date: 08 June 2023

Applicability - All Eligible Market Participants

In alignment to Term Money Market borrowing, Scheduled Commercial Banks (excluding small finance banks and payment banks) banks are required to establish internal board-approved limits for borrowing in these markets, adhering to the prudential limits for inter-bank liabilities set by the Department of Regulation.

Prior to this amendment, the extant guidelines on the Call, Notice, and Term Money Markets imposed prudential limits on outstanding borrowings for Scheduled Commercial Banks.

These limits were defined as follows:

- 100% of capital funds, on a daily average basis in a reporting fortnight,
- 125% of capital funds on any given day

Following are the key impacts:

1 Flexibility for banks

Flexibility to determine their own borrowing limits to tailor their borrowing strategies based on their liquidity needs and market conditions.

2 Risk management

Internal board-approved limits provide a mechanism for banks to manage and control their exposure to call and notice money markets ensuring that banks do not exceed prudent limits that could pose risks to their financial stability.

3 Market dynamics

Increased participation, competition, and more efficient market operations as banks navigate their borrowing strategies within the specified limits.

4 Compliance and governance

The requirement for internal board-approved limits reinforces the importance of governance and compliance within banks. Boards need to ensure that borrowing decisions align with the overall risk appetite and strategic objectives of the institution.

5 Adaptation to market changes

Banks can more effectively adapt to changes in market conditions, interest rates, and liquidity demands by having the autonomy to set their own borrowing limits.

6 Monitoring and reporting

Banks will likely enhance their monitoring and reporting mechanisms to track compliance with internal limits and regulatory guidelines. Thus, promotes transparency and accountability in their market activities.

7 Impact on liquidity management:

The regulation could influence how banks manage their liquidity positions. With more control over borrowing limits, banks can fine-tune their liquidity management strategies, potentially leading to more efficient utilization of funds.

04

Regulatory measures towards consumer credit and bank credit to NBFCs

Effective date: 16 November 2023

Applicability-

- Commercial Banks (including Small Finance Banks, Local Area Banks, and Regional Rural Banks)
- NBFCs (including HFCs)

RBI has increased the risk weights for consumer finance assets in the books of banks and NBFCs. RBI Governor's entire policy statement dated 06 October 2023 was based on risk mitigation and underwriting. Based on the governor's statement, RBI has justified the increase in risk weights by saying that this will help strengthen the internal surveillance system and safeguard the interest of the financial sector.

The enhanced risk weights for consumer credit exposure for commercial banks and for NBF's' and the increased scrutiny on credit card receivables are all part of this directive. Furthermore, the circular extends its purview to the realm of bank credit to NBFCs, introducing stringent measures to ensure that exposures align with prudent risk management practices.

The below able summarizes the significant changes as per the new circular

Particular	Existing risk weights	Revised risk weights
Consumer credit exposure		
► Commercial banks and NBFCs	100%	125%
Credit card receivables		
► Scheduled Commercial Banks	125%	150%
► NBFCs	100%	125%
Bank credit to NBFCs	Risk weight associated with external credit rating as provided in para 5.8 of Master Circular – Basel III Capital Regulations	Existing risk weight is increased by 25% if the risk weights as per external credit rating is below 100%. There is no change if the risk weights are already 100% or more

Strengthening credit standards

- The RBI mandates regulated entities to review and set board-approved limits for subsegments in consumer credit, emphasizing prudent risk management. Strict adherence to these limits, monitored by the Risk Management Committee, is crucial.
- Additionally, the RBI has classified all top-up loans against inherently depreciating movable assets, such as vehicles, as unsecured loans for credit appraisal, prudential limits, and exposure purposes.

Immediate implementation

The regulatory measures are effective immediately from the date of the notification, except requirements related to board approved limits in consumer credit sub-segments, which need compliance by the covered entities by 29 February 2024.

How we see it:

The move by the RBI is a prudent regulatory practice which aims at enhancing financial stability by curbing the issuing of loans against riskier assets, which has been on the rise since the FinTech revolution in online, mobile-based, and instant lending and lending through business correspondents. The increased risk weights will serve as a safeguard, compelling SCBs and NBFCs to allocate more capital to cover potential losses, thereby minimizing systemic risks.

Management may contemplate carrying out an impact assessment and determine the subsequent course of action for the below mentioned areas:

- **ECL provisioning and accounting considerations** - Banks and NBFCs, in response to increased risk weights, should reassess ECL provisioning. While an increase in risk weights does not necessarily lead to an increase in ECL, it may be useful to re-assess the estimates and assumptions including forward looking factors in computing the ECL provision for the impacted portfolios, considering that the regulatory measure is on account of the perceived stress in such portfolio by the regulator.
- **Capital mobilization** - To comply with increased regulatory requirements, regulated entities may need to secure additional capital, requiring a reassessment by financial planning teams and explore fundraising options aligned with strategic objectives. NBFCs can also consider tapping into the debt capital markets to fulfill their funding needs.
- **Exposure reallocation** - The regulatory measure may necessitate a more cautious approach to the exposure across various lending segments. financial planners must reevaluate exposure targets, shifting focus from high-risk segments to alternative, lower-risk areas in consumer lending. This strategic reallocation requires a delicate balance to optimize returns within the confines of the revised risk framework.
- **Immediate target adjustments** - Recognizing the altered risk landscape and regulatory expectations, the financial planning and budgeting function must promptly revisit annual targets. This includes revising loan disbursement goals, revenue projections, and profit targets for the consumer lending segment, aligning them with the revised risk weights and regulatory compliance requirements.
- **Capital adequacy and financial health** - Increased risk weights in consumer lending directly affect the Capital Adequacy Ratio (CAR), necessitating higher regulatory capital to absorb potential losses. However, the challenge lies in balancing this increased capital demand with the need for profitability and sustainable growth, thereby putting financial health under scrutiny.
- **Loan Pricing and Interest Rates** - As banks adjust to higher risk perceptions, they are likely to charge elevated interest rates to NBFCs. This, in turn, escalates the borrowing costs for NBFCs, which may recalibrate their loan pricing strategies in response. Consequently, borrowers may experience adjustments in the cost of credit, potentially impacting consumer spending patterns and overall economic dynamics.

The move by the RBI is a prudent regulatory practice which aims at enhancing financial stability by curbing the issuing of loans against riskier assets, which has been on the rise since the FinTech revolution in online, mobile-based, and instant lending and lending through business correspondents. The increased risk weights will serve as a safeguard, compelling SCBs and NBFCs to allocate more capital to cover potential losses, thereby minimizing systemic risks.

05

Display of Information: Secured assets possessed under the SARFAESI Act, 2002

Effective date: 25 September 2023

Applicability-

- All Commercial Banks including Small Finance Banks, Local Area Banks and Regional Rural Banks and excluding Payment Banks
- All Primary (Urban) Co-operative Banks/ State Co-operative Banks/ Central Co-operative Banks
- All India Financial Institutions (EXIM Bank, NABARD, NHB, SIDBIs and NaBFID)
- All NBFCs including HFCs.
- All Asset Reconstruction Companies

RBI vide the above circular, has directed the REs

- REs to display the information regarding borrowers whose secured assets have been taken into possession under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 in the format prescribed by the RBI, on their respective websites.
- REs shall publish the initial list, featuring details of secured assets acquired, on their website within six months from the circular issuance date. Subsequently, they are required to update this information on a monthly basis.

The following information is to be provided in the format prescribed by the RBI

- Branch name
- State
- Borrower name
- Guarantor Name (if applicable)
- Registered address of the Borrower
- Registered address of the Guarantor (if applicable)
- Outstanding amount (in INR)
- Asset classification
- Date of asset classification
- Date of asset possession
- Name and title holder of the security possessed

How we see it:

RBI aims to enhance transparency and accountability in the handling of secured assets. This initiative also aims to provide useful information for potential buyers, enabling them to verify details of the security possessed/under consideration and identify the title holder of securities available for sale or auction.

06

Revised Guidelines on Inoperative Accounts and Unclaimed Deposits: Streamlining banking practices for enhanced compliance

Effective date: 01 April 2024

Applicability - Commercial Banks (including RRBs) and all Co-operative Banks

The guidelines will address operational challenges associated with inoperative accounts while emphasizing transparency and adherence to regulatory standard.

The following key aspects are integral to the framework outlined in this circular

Type of security	Valuation methodology
Inoperative Accounts Definition	► Any credit balance in a savings or current account shall be treated as inoperative, if there are no 'customer induced transactions' for a period of over two years. ► Banks are prohibited from allowing debit transactions in inoperative accounts unless customer-induced activation occurs.
Assessment at customer account level	Classification as inoperative shall be for a particular account of the customer individually and not with reference to the customer
Transfer to DEA Fund	If an account remains inoperative for ten years or more, the bank must transfer the credit balance to the Depositor Education and Awareness (DEA) Fund maintained by the RBI.
Exception to zero balance accounts	Zero balance accounts for scholarship credits and Direct Benefit Transfer under Government Schemes are exempt from inoperative status.
Annual review requirement	► Savings and current accounts with no customer-induced transactions for over a year. ► Term deposit accounts with no explicit renewal mandate and no withdrawals after maturity.
Alert messages	Send alert messages through letters, emails, or SMS to account holders notifying the facts of no-account activity in the last year, further mentioning the consequences of an inoperative account.
Interest on savings accounts	Interest on savings accounts will be regularly credited, and no penal charges will be levied for non-maintenance of minimum balances
Activation of Inoperative Accounts	► Updating or conducting re-KYC by the account holder at all branches ► Activation process in the Core Banking System (CBS) to follow a maker and checker process and should be completed within three working days without any charges. ► Reactivated accounts to be monitored for at least six months.
Display of Unclaimed Deposits and Search Facility	Display information about unclaimed deposits on their websites, including only the name, address (excluding pin code), and Unclaimed Deposit Reference Number. This information should pertain to deposits transferred to the DEA Fund of RBI and must be updated on the bank's websites at least monthly.

How we see it:

- The guidelines emphasize streamlining banking practices to ensure enhanced compliance. By setting clear definitions and rules for inoperative accounts, the RBI seeks to make the banking system more efficient and accountable.
- This initiative aims to complement ongoing efforts to reduce unclaimed deposits in the banking system and facilitate the return of such deposits to their rightful owners or claimants.
- Currently, individuals must navigate various bank websites to claim unclaimed deposits, and the new portal is designed to improve and broaden access to information on these deposits.

07

Appointment of Whole-Time Director(s)

Effective date: 25 October 2023

Applicability -

- Private Sector Banks and
- Wholly Owned Subsidiaries of Foreign Banks (Excluding Payment Banks and Local Area Banks)

Through this circular, RBI has advised banks to ensure the presence of at least two WTDs on their Boards, including the MDs and CEOs. The exact number of WTDs should be decided by the bank's Board, considering factors such as the size of operations, business complexity, and other relevant aspects.

Compliance timelines with circular

- Banks that currently do not meet the minimum requirement (i.e., having two WTDs) are urged to submit their proposals for WTD appointments within four months from the date of this circular.
- Banks lacking the enabling provisions regarding WTD appointments in their Articles of Association should promptly seek necessary approvals to comply with these requirements.
- Careful consideration must also be given to meeting other applicable statutory and regulatory provisions.

How we see it:

RBI's objective is to enhance stability and strengthen the leadership within banks to navigate ongoing and emerging challenges. This initiative also facilitates succession/replacement planning by regulating the tenure and upper age limits of MDs and CEOs and WTDs.

Responsible Lending Conduct - Release of Movable/ Immovable Property Documents on repayment/settlement of Personal Loans

Effective date: 01 December 2023

Applicability -

- All Commercial Banks (including Small Finance Banks and Regional Rural Banks, excluding Payments Banks)
- All Local Area Banks
- All Primary (Urban) Co-operative Banks
- All State Co-operative Banks and District Central Co-operative Banks
- All NBFCs (including HFCs)
- All Asset Reconstruction Companies

REs are required to release all movable / immovable property documents upon receiving full repayment and closure of the loan account. Due to divergent practices followed by RE, an increase in customer grievances and disputes have been observed. To address the said concern, on 13 September 2023, RBI issued directions on release of documents on full repayment/closure of loan account in terms of guidelines on Fair Practice Code applicable to All India Financial Institutions (Regulated Entities or "REs").

These directions are applicable to all personal loans where the release of original movable / immovable property documents falls due on or after 01 December 2023. Personal Loan refers to loans given to individuals and consist of (a) consumer credit, (b) education loan, (c) loans given for creation/ enhancement of immovable assets (e.g., housing, etc.), and (d) loans given for investment in financial assets (shares, debentures, etc.).

Release on Movable/ Immovable Property Documents by RE

- All the original documents and charges registered with any registry to be removed within a period of 30 days after full repayment/ settlement of the loan account.
- Option to borrower to collect documents from the banking outlet/ branch where the loan account.
- Timeline and place of return of original documents to be mentioned in the loan sanction letters issued on or after the effective date.
- RE to hand over the return of original documents to the legal heirs in case contingent event such as demise of the borrower and to display details on the website of RE.

Compensation for delay in release of Movable/ Immovable Property Documents

- Delay in release of original document: In case where the delay is attributable to the RE, it shall compensate the borrower at the rate of INR5,000 for each day of delay communicating the reasons for delay.
- Loss/damage to original document: Assist the borrower in obtaining duplicate/ certified copies of the movable / immovable property documents and shall bear the associated costs. Penalty of INR 5,000 per day to be paid by RE in case were the duplicate / certified documents are not made available to borrowers within 60 days.

09

Master Direction on Information Technology Governance, Risk, Controls and Assurance Practices

Effective date: 01 April 2024

Applicability -

- Chairman/Managing Director/Chief Executive Officer
- Scheduled Commercial Banks (excluding Regional Rural Banks).
- Small Finance Banks; Payments Banks.
- NBFCs.
- Credit Information Companies; and
- All India Financial Institutions (EXIM Bank, NABARD, NaBFID, NHB and SIDBI)

These Directions shall not be applicable to:

- Local Area Banks
- NBFC - Core Investment Companies

Foreign banks operating in India through branch mode, reference to the Board or Board of Directors in these Directions should be read as reference to the Head Office or controlling office which has the oversight over the branch operations in India. The 'comply or explain' approach shall allow such foreign banks to deviate from any specific part of these Directions subject to examination and acceptance by RBI of a reasonably justifiable explanation for the same, as part of the supervisory process.

IT Governance

- REs shall put in place a robust IT Governance Framework based on the following focus areas:

Key focus areas

- Strategic alignment
- Risk management
- Resource management
- Performance management
- Business continuity/ Disaster recovery management

- The IT Governance Framework put in place shall

1. Specify the governance structure and processes necessary to meet the RE's business/ strategic objectives.
2. Specify the roles (including authority) and responsibilities of the Board of Directors (Board) / Board level Committee and Senior Management.
3. include adequate oversight mechanisms to ensure accountability and mitigation of IT and cyber/ information security risks.
4. Incorporate periodic assessment of IT-related risks (both inherent and potential risk).

It also lists down the different types of committees and heads that are required to be established/appointed, along with matters covering its composition, roles and responsibilities and minimum number of meetings in a year.

Parties involved in IT governance

- Board of directors
- Senior management
- Head of IT
- IT stratergy committee
- IT steering committee

IT Infrastructure and Services Management

This chapter describes the various processes and service arrangements which are required for supporting their information systems and infrastructure to ensure the operational resilience of their entire IT environment.

The different processes, arrangements and controls which are discussed in this chapter are as follows:

- IT services management
- Third party arrangements
- Capacity management
- Project management
- Change and patch management
- Date migration control
- Audit trail
- Cryptographic controls
- Straight through processing
- Physical and environmental controls
- Access controls
- Controls on teleworking
- Metrics

IT and Information Security Risk Management

1 Periodic review of IT related risks

The Risk Management Committee of the Board (RMCB) in consultation with the ITSC shall periodically review the risks and update the same, at least on a yearly basis.

2 IT and Information Security Risk Management Framework

REs shall establish a robust framework, including details of implementation of a comprehensive information security management function, internal controls and processes defining roles and responsibilities of stakeholders and identification of critical information systems.

3 Information Security Policy and Cyber Security Policy

REs shall put in place an information security policy along with a cyber security policy and cyber crisis management plan. For management of cyber/information security, an Information Security committee (ISC) is to be formed, defining and documenting their responsibilities. A senior level executive (preferably in the rank of a General Manager or an equivalent position) shall be designated as the Chief Information Security Officer (CISO).

4 Risk assessment

The risk assessment for each information asset within the RE's scope shall be guided by appropriate security standards/ IT control frameworks with annual reviews and take steps to adequately tackle cyber-attacks, including phishing and spoofing attacks and mitigate their adverse effects.

5 Conduct of Vulnerability Assessment (VA) / Penetration Testing (PT)

- For critical information systems and/ or those in the De-Militarized Zone (DMZ) having customer interface, VA shall be conducted at least once in every six months and PT at least once in 12 months, whereas for non-critical information systems, a risk-based approach shall be adopted.
- REs shall ensure to fix the identified vulnerabilities and associated risks in a time-bound manner by undertaking requisite corrective measures and ensure that the compliance is sustained.
- REs shall put in place a documented approach for the conduct of VA/ PT.

6 Cyber Incident Response and Recovery Management

- The cyber incident response and recovery management policy shall address the classification and assessment of incidents; include a clear communication strategy and plan to manage such incidents, contain exposures, and achieve timely recovery.
- REs shall have clear communication plans for escalation and reporting the incidents to the Board and Senior Management as well as to customers, as required.

Business Continuity and Disaster Recovery Management

The business continuity plan (BCP) and disaster recovery (DR) policy shall adopt best practices to guide its actions in reducing the likelihood or impact of the disruptive incidents and maintaining business continuity.

Information Systems (IS) Audit

The Audit Committee of the Board (ACB) shall be responsible for exercising oversight of IS audit of the RE. REs shall put in place an ACB approved IS audit policy, which is to be reviewed annually. The ACB shall review critical issues highlighted related to IT / information security / cyber security and provide appropriate direction and guidance to the RE's management.

10

Master Direction on Outsourcing of Information Technology Services

Effective date: 01 October 2023

Applicability -

- Scheduled Commercial Banks (excluding Regional Rural Banks).
- Local Area Banks; Small Finance Banks; Payments Banks.
- Primary (Urban) Co-operative Banks.
- NBFCs.
- Credit Information Companies; and
- All India Financial Institutions (EXIM Bank, NABARD, NaBFID, NHB and SIDBI)

Regulated entities (RE) must ensure compliance as follows

Period of existence	To be complied by
Existing outsourcing agreements due for renewal and new arrangements that come into force before 01 October 2023	Within 12 months from the date of issuance of the Master Directions
Existing outsourcing agreements due for renewal after 01 October 2023	As on the renewal date or 36 months from the date of issuance of the Master Directions, whichever is earlier
New outsourcing agreement, which has come into force on or after 01 October 2023	Date of agreement.

Material outsourcing of IT Services is defined as below

- If disrupted or compromised shall have the potential to significantly impact the RE's business operations.
- May have material impact on the RE's customers in the event of any unauthorized access, loss, or theft of customer information.

Key components of the Master Direction

- Role of the Regulated Entity
- The governance framework
- Evaluation and engagement of service providers
- Outsourcing agreement
- Risk management
- Monitoring and control of outsourced activities
- Outsourcing within a group / conglomerate
- Cross border outsourcing
- Exit strategy

Role of the Regulated Entity

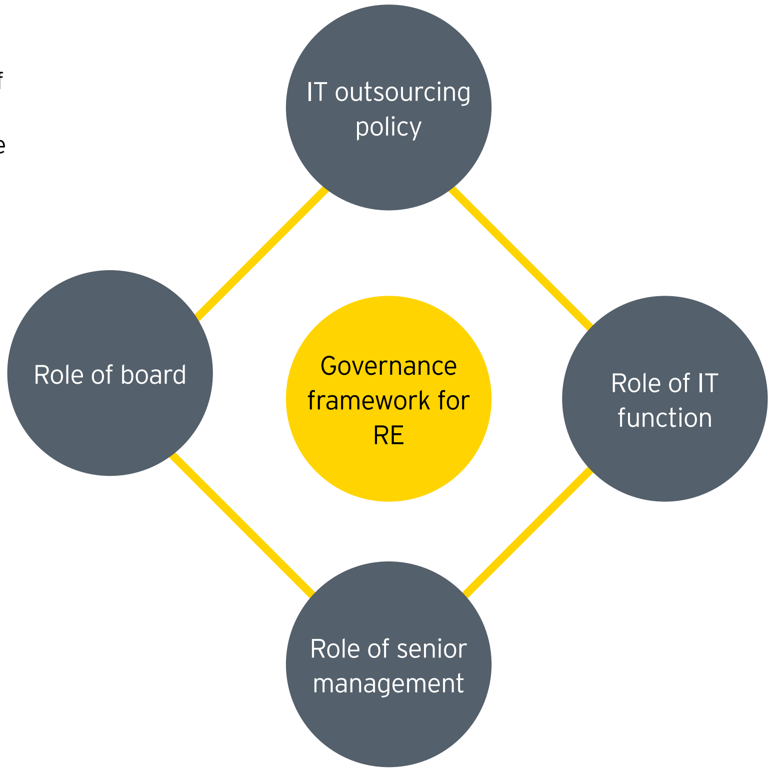
This section covers the following points

- Regulatory and supervisory requirements
- Comprehensive assessment of need for outsourcing and attendant risks
- Compliance with all applicable statutory and regulatory requirements
- Grievance redressal mechanism
- Inventory of outsourced services

- These guidelines state that outsourcing any activity should not diminish the RE's obligations, and the Board and Senior Management are ultimately responsible for the outsourced activity.
- The REs must ensure that the service provider employs the same high standard of care as the RE and that the outsourcing does not impede their ability to effectively oversee and manage their activities.
- The RE must also comply with all applicable statutory and regulatory requirements when performing its due diligence in relation to outsourcing of IT services.
- Additionally, REs shall have a robust grievance redressal mechanism that shall not be compromised in any manner on account of outsourcing, and they shall create an inventory of services provided by the service providers.

The Governance Framework

- The guidelines require REs intending to outsource any of their IT activities to put in place a comprehensive board-approved IT outsourcing policy and must incorporate the roles and responsibilities of Board, Senior Management, and IT function.
- It shall further cover the details for the following
  - Criteria for selection of such activities
  - Service providers
  - Parameters for defining material outsourcing
  - Delegation of authority
  - Disaster recovery and business continuity plans
  - Systems to monitor and review the operations
  - Termination processes and exit strategies



Evaluation and Engagement of Service Providers

- REs to conduct due diligence while considering or renewing an outsourcing of IT Services arrangement.
- The evaluation of service providers should involve the assessment of the following.
  - Their past experience
  - Financial soundness
  - Business reputation and culture, compliance, complaints, outstanding or potential litigations,
  - Conflict of interest
  - External factors
  - Technology, infrastructure stability, security, and internal control, audit coverage, reporting and monitoring procedures, data backup arrangements, business continuity management and disaster recovery plan
  - Capability to identify and segregate RE' s data
  - Quality of due diligence exercised by the service provider with respect to its employees and sub-contractors, ability to comply with regulatory and legal requirements,
  - Information/cyber security risk assessment, data protection, confidentiality, and the ability to enforce agreements and the rights available thereunder.

Outsourcing Agreement

- REs are required to ensure that the rights and obligations of the REs and their Service Providers are clearly set out in a legally binding written agreement which is effective and enforceable, duly vetted by the REs' legal counsel.
- Certain key elements to be specified in such an agreement include:
  - Details of the activity being outsourced and access to be given to the REs of all data available with the service provider.
  - Audit, monitoring and inspection rights of the service provider by the REs and RBI.
  - Types of material adverse events (e.g., data breaches, etc.) and incidents required to be reported by the service provider to REs.
  - Obligation of service provider to comply with provisions of IT Act,2000 for protection of customer's data and directions issued by RBI in relation to activities outsourced to service provider.
  - Storage of data only in India as per extant regulatory requirements
  - Clauses requiring non-disclosure of information and prior approval / consent of REs for the use of sub-contractors by the service provider.
  - Contingency plans to ensure business continuity and testing requirements.
  - Termination rights of the REs, obligation by the service provider to co-operate in case of insolvency of the RE.

Risk Management

1 Risk Management Framework

- REs should put in place a risk management framework for outsourcing of IT Services that comprehensively deals with the processes and responsibilities for identification, measurement, mitigation, management, and reporting of risks associated with outsourcing of IT services arrangements, and for confidentiality and integrity of customer's data.
- Where a service provider acts as an outsourcing agent for multiple REs, it should be ensured that each RE has adequate safeguards to avoid combining information, documents, records, and assets.
- REs are required to ensure that cyber incidents are reported to them by their Service Providers without undue delay, so that the same can be reported by the REs to the RBI within 6 (six) hours of detection by the service providers.
- REs are also required to monitor the service provider's control processes and security practices to disclose security breaches, and immediately notify the RBI in case of any breach of security and leakage of confidential customer information.
- REs shall effectively assess the impact of concentration risk posed by multiple outsourcings to the same service provider and/or outsourcing critical or material functions to a limited number of service providers.

2 Business Continuity Plan and Disaster Recovery Plan

- REs are required to ensure that their service providers develop a robust framework for documenting, maintaining, and testing business continuity and disaster recovery plans, commensurate with the IT services outsourced as per instructions issued by RBI.
- In this regard, REs are required to consider the availability of alternative service providers or the possibility of bringing the outsourced IT services back in-house in an emergency, and the costs, time and resources that would be involved.

Monitoring and Control of Outsourced Activities

- REs shall have in place a management structure to monitor and control its outsourced IT activities. This will include monitoring the performance, uptime of the systems and resources, service availability, incident response mechanism, etc.
- Regular audits of service providers should be conducted, as applicable to the scope of outsourced IT services.
- Where many REs avail services from the same service provider, REs may adopt a pooled/ shared audit.
- The audits shall assess:
  - Performance of the service provider,
  - Adequacy of the risk management practices.
  - Compliance with laws and regulations, etc.
- The RE shall periodically review the financial and operational condition of the service provider.
- In the event of termination of the outsourcing agreement, the same shall be given due publicity by the RE.
- REs shall ensure that the service provider grants unrestricted and effective access to:
  - Data related to the outsourced activities.
  - The relevant business premises, subject to appropriate security protocol.

Outsourcing within a Group / Conglomerate

- REs may outsource any IT service within its business group/ conglomerate, provided that such an arrangement is backed by the Board-approved policy and appropriate service level agreements.
- REs must adopt risk management practices for such outsourcing and continue to maintain an arm's length relationship in dealings with their group entities.

Cross Border Outsourcing

- In case of outsourcing of IT services to a service provider based in a jurisdiction other than India, REs are required to closely monitor:
  - Government policies
  - Political, social, economic, and legal conditions of such jurisdiction
- The aim is to establish procedures for mitigating any country level risks (including having suitable contingency and exit strategies).
- REs are also required to ensure the availability of records to it and the RBI is not affected even in case of liquidation of the service provider.

Exit Strategy

- The outsourcing of IT services policy should contain a clear exit strategy with regard to outsourced IT activities and IT enabled services.
- The strategy should ensure business continuity during and after exit.
- In documenting an exit strategy, the RE should identify alternative arrangements, which may include:
  - Transitioning the activity to a different service provider.
  - Bringing the activity back in-house (handled by the RE itself).
- REs shall ensure strategy has necessary provision for:
  - Safe removal/ destruction of data, hardware, and all records (digital and physical)
  - Obligating the service provider to cooperate in smooth transition.
  - Prohibiting service provider from erasing, purging, revoking, altering, or changing any data during the transition period.

11

Reset of Floating Interest Rate on Equated Monthly Instalments (EMI) based Personal Loans

Effective date: 31 December 2023

Applicability -

- Scheduled Commercial Banks
- Regional Rural Banks
- Primary (Urban) Co-operative Banks
- State Co-operative Banks and District Central Co-operative Banks
- NBFCs (including HFCs)

The guidelines are applicable to personal loans with equated instalments of different periodicities (monthly/quarterly/half-yearly, etc.)

This framework will apply only in case of Personal Loans as per the RBI Circular – XBRL Returns – Harmonization of Banking Statistics dated 04 January 2018, which includes loans given to individuals and consist of consumer credit, education loan, loans given for creation/ enhancement of immovable assets, and loans given for investment in financial assets.

In order to address the concerns of consumer grievances related to elongation of loan tenor and/or increase in EMI amount, without proper communication with and/or consent of the borrowers, RBI has issued guidelines for REs to set up appropriate policy framework meeting the following requirements:

1 Options to borrowers on reset of floating interest rate

- Enhancement of EMI
- Elongation of tenor
- Combination of both of the above options
- To prepay, either in part or in full (subject to levy of foreclosure charges/ pre-payment penalty, if any)
- Switch over to fixed rate along with applicable charges, if any (as per Board-approved policy where in the number of times a borrower will be allowed to switch the fixed to floating and visa-versa during the tenor of the loan is specified)

2 Sanction of Loan REs will be required to

- clearly communicate to the borrowers the possible impact on EMI/tenor or both, on change in floating interest due to change in the benchmark rate.
- Include all applicable charges, including any other service charges/ administrative costs incidental to exercise of the above options in the sanction letter.

3 RE shall

- Ensure that elongation of tenor does not result in negative amortisation i.e., an increase in principal balance.
- Share quarterly loan statements with the borrowers which are simple and easy to understand, with details of principal and interest recovered till date, EMI amount, number of EMIs left and annualized rate of interest / Annual Percentage Rate (APR) for the entire tenor of the loan.

How we see it:

With increased compliance on the RE guidelines aims to increase transparency for the borrower for the cases where interest rate reset would be applicable. The circular increases the efforts of an entity to maintain adequate documentation and ensures effective communication is provided to the borrowers.

12

Classification of MSMEs

Effective date: 28 December 2023

Applicability - All Scheduled Commercial Banks (except RRBs) (including Small Finance Banks and Local Area Banks)

As per RBI, the current amendment with respect to the requirement of online registration on the Udyam Registration portal, all MSME enterprises are required to register online on the portal and obtain 'Udyam Registration Certificate.' For Priority Sector lending (PSL) purposes, banks shall be guided by the classification recorded in the Udyam Registration Certificate (URC).

C

List of Master circular updates

Sno.	Circular date	Circular number	Circular name	Remarks
1	01-04-2023	RBI/2023-24/04	Master Circular - Guarantees and Co-acceptances	This Master circular consolidates instructions related to circular name issued up to 31 March 2023
2	01-04-2023	RBI/2023-24/06	Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances	This Master circular consolidates instructions related to circular name issued up to 31 March 2023
3	03-04-2023	RBI/2023-24/08	Master Circular – Housing Finance	This Master circular consolidates instructions related to circular name issued up to 31 March 2023
4	03-04-2023	RBI/2023-24/12	Master Circular - Asset Reconstruction Companies	The instructions contained in The Asset Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003 vide notification and guidance notes are reproduced in this master circular
5	12-05-2023	RBI/2023-24/31	Master Circular – Basel III Capital Regulations	Instructions contained in this Master Circular have been suitably updated/ amended by incorporating relevant guidelines from previous circular dated 01 April 2022

D

Other discussion paper updates

On 16 January 2023, RBI had released the 'Discussion Paper (DP) on Introduction of ECL Framework for Provisioning by Banks'. The DP proposed a framework for adoption of an expected loss framework and included discussion questions on which a final view would be taken based on the feedback received and after analyzing comprehensive data. The feedback/ comments/ suggestions were required to be submitted to the RBI by 28 February 2023, based on which the RBI shall be issuing the final guidelines. Further to the final guidelines, RBI constituted a nine-member committee consisting of domain experts from academia, industry, and representatives from selected banks. The Working Group will be chaired by R Narayanaswamy, former Professor, IIM Bangalore. The terms of reference for the Working Group are as follows :

- Defining the principles that will be required by banks to be considered while designing the credit risk models. This model will be used for assessing and measuring ECL
- Recommending factors that banks should consider for the determination of credit risk based on the guidance provided in IFRS (International Financial Reporting Standard) 9 and principles laid out by Basel Committee on Banking Supervision (BCBS)
- Suggesting methodology to be used for undertaking external independent validation of the models
- Recommending prudential floors for provisioning based on comprehensive data analysis

Forming a working group consisting of domain experts would help in smooth transitioning and implementation of ECL.

Ind AS 117 - Exposure draft - Implications for Indian insurers

The Accounting Standard Board of ICAI issued the exposure draft on the Insurance Accounting Standard, Ind AS 117 Insurance Contracts (the Standard) with amendments on 24 December 2020. The amendments were corresponding to the amendments in IFRS 17 (IASB standard for Insurance Contracts).

This standard will represent the most significant change to Indian insurance accounting requirements in many years, requiring insurers to entirely overhaul their financial statements.

Given the scale of this change, investors and other stakeholders would like to understand the likely impact as early as possible.

The standard prescribes three measurement approaches:

- General model or Building Block Approach (BBA) – Default measurement approach. Generally, for long-term contracts.
- Premium Allocation Approach (PAA) – Premium Allocation Approach (PAA) (optional) - for all contracts of one year or less, and certain contracts of more than one year that are PAA eligible.
- Variable Fee Approach (VFA) – for contracts with direct participation features.

The principles underlying these measurement approaches result in a fundamental change to current practice, particularly for long-duration contracts. The requirements are marked differently from the existing accounting in several critical aspects that will:

- Change in profit emergence patterns.
- Increase the frequency of loss recognition.
- Add complexity to valuation processes, data requirements, assumption setting, etc.

Insurers need to interpret and analyze the requirements of the insurance contract standard in the context of their product portfolio. The process involves significant time and effort. The major change program is required, which extends beyond finance and actuarial teams and its impacts will need to be communicated to a broad range of internal and external stakeholders, including investors.

In addition to the standard, insurers will need to adopt other accounting changes, including:

- IND AS 109 Financial Instruments for investments
- IND AS 115 Revenue from Contracts with Customers
- IND AS 116 Leases

Given the scale of the insurance standard's impact, and the complexity of the implementation task, insurers need to proactively start assessing impacts and mobilize the resources.

Below are the key actions for the insurers which serve as the precursor for successful implementation of insurance contracts standard.

Six actions to kick-start your implementation program

1. Educate the executives on the new requirements and implications.
2. Identify the key methodology and design decisions and assumptions driving implementation.
3. Analyze the financial, operational and system implications.
4. Draft budget and plan human resourcing requirements.
5. Assess implications on other current or planned system change programs
6. Assess any implications on the product.

Key considerations for implementation of insurance contract standard

1 CFO

- Communicate early to key stakeholders, including market analysts and shareholders, providing clarity around the expected impacts to the financial statements and profit profiles.
- Analyse current management reporting, key performance indicators and incentive frameworks for ongoing applicability, and incorporate necessary changes for analysing margins and volatility.
- Update volatility and asset-liability management frameworks for measurement changes under IND AS 117 and assets under IND AS 109

2 Finance

- Update the chart of accounts and account mappings to cover new disclosures.
- Prepare pro forma balance sheet, Profit and Loss (P&L) and note disclosure formats to meet new requirements of Ind AS.
- Update accounting policies and practice manuals.
- Analyse financial close reporting processes, including target operating model for finance function along with updated responsibilities and timelines.
- Design specific controls to ensure process quality, robustness, and integration.
- Update process and controls documentation.
- Create new, or revise, existing internal (e.g., forecasts and other management reports) and external (e.g., investor and analyst packs) reporting templates.
- Design and complete the significant note disclosures for each reporting period.
- Focus on the auditability of reported figures – this will require a high level of interaction and consultation with the external auditor during the implementation process.

3 Actuarial function

- Allocate time and resources to projects to design, build and test new data, modelling and systems capability.
- Update methodology guidance for risk adjustment, discount curve and assumption setting.
- Perform contract level assessment along with the 'Finance'' function to analyse important aspects such as level of aggregation, initial recognition. contract boundary, investment components, service components etc.
- Buy/Develop a new calculation engine for performing complex IND AS 117 calculations to capture all movements in the Insurance liabilities incl. release of expected cash flows, interest accretion on CSM, changes in the discount rate, changes in estimates, changes related to future services impacting CSM etc.
- Work with the finance team to estimate impacts on transition and design optimal approaches based on the availability of historical data.
- Reported figures should have traceability and auditability.
- Analysis of earnings volatility and measure to mitigate.

4 Business finance and operations

- Assess current data availability against new data requirements for both model inputs and outputs.
- Change the content and structure of data captured from business units to support group reporting if applicable.
- Enhance scrutiny of data quality, storage and governance given the retrospective transition requirements, this should happen ahead of the date of implementation.
- Select, design, and implement new IT systems to facilitate efficient reporting.

5 Investments

Review investment policies and asset liability management strategy based on the impacts of the new measurement models for both insurance contracts and financial instruments.

IND AS 109 Implementation

- IND AS 109 comprises two key topics impacting insurers:
  - Classification and measurement
  - Impairment
- Based on a business model test and cash flow characteristics test, financial instruments (investments, receivables) will be classified as one of the following:
  - Debt instruments at amortized cost
  - Debt instruments at fair value through other comprehensive income (FVOCI) – with realized gains and losses reclassified to profit and loss
  - Debt instruments, derivatives, and equity instruments at fair value through profit or loss
  - Equity instruments designated at FVOCI (without gains and losses reclassified to profit and loss)
- That said, the option of a conditional fair value through profit and loss will still be available to mitigate the accounting mismatches.
- For debt instruments not measured at fair value through profit and loss, a significantly different impairment model will apply. This will be an expected loss model, reassessed at each reporting period.

Implications for insurers

A key consideration for implementation will be to ensure that the suitable accounting policy choices are made for both assets and liabilities.

Under IND AS 117, Insurers will be able to choose whether to report the impact of changes in market discount rates arising on insurance contract liabilities in profit and loss, or directly in equity through Other Comprehensive Income (OCI). However, IND AS 109 only allows assets which meet specific criteria to be classified as at fair value through other comprehensive income (FVOCI). This means that accounting mismatches could arise from the way that changes in market interest rates are reported on assets and liabilities.

Key to the link between IND AS 109 and IND AS 117 is evaluating whether to use the OCI option for the insurance liabilities, and how to best align this with the mixed measurement model for the assets to manage the profit and loss volatility.

Another key consideration will be the extent to which the implementation project considers interplay between both the standards. Changes which will be needed to be made to accounting manuals, charts of accounts and financial statements should consider the impact of both standards together. In addition, financial impact analyses would need to consider impacts on both assets and liabilities under the new standard.

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