Basel Committee
on Banking Supervision

Regulatory Consistency Assessment Programme (RCAP)

Assessment of Basel III LCR regulations – India

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Glossary

ALA	Alternative Liquidity Approaches
ALCO	Asset liability management committee
ALM	Asset liability management
BCBS	Basel Committee on Banking Supervision
BoD	Board of directors
BR	Banking regulation
CFP	Contingency funding plan
CLF	Committed liquidity facility
CRR	Cash Reserve Ratio
DICGC	Deposit Insurance and Credit Guarantee Corporation
FALLCR	Facility to Avail Liquidity for Liquidity Coverage Ratio
FAQs	Frequently asked questions
G-SIB	Global systemically important bank
HKMA	Hong Kong Monetary Authority
HQLA	High-quality liquid assets
INR	Indian rupee
LCR	Liquidity Coverage Ratio
MSF	Marginal Standing Facility
NDTL	Net Demand and Time Liabilities
PSEs	Public sector entities
RBI	Reserve Bank of India
RCAP	Regulatory Consistency Assessment Programme
SDL	State Development Loan
SLR	Statutory Liquidity Requirement
SSL	Statement of Structural Liquidity

Preface

The Basel Committee on Banking Supervision (Basel Committee) sets a high priority on the implementation of regulatory standards underpinning the Basel III framework. The prudential benefits from adopting Basel standards can only fully accrue if these are implemented appropriately and consistently by all member jurisdictions. The Committee's Regulatory Consistency Assessment Programme (RCAP) thus helps monitor, assess and evaluate its members' implementation practices, including follow-up steps taken by individual members.

This report presents the findings of the RCAP Assessment Team on the domestic adoption of the Basel LCR standards in India. The assessment focuses on the regulatory adoption of Basel LCR standards applied to the Indian banks that are internationally or regionally active and of significance to its domestic financial stability.

The RCAP LCR assessment was based primarily on the LCR rule issued by the Indian authorities in June 2014. In the course of the assessment, the authorities made a number of revisions to the rule based on issues identified by the Assessment Team. This report has been updated, where relevant, to reflect the progress made by the Indian authorities to align the regulations with the Basel standard.

The RCAP Assessment Team was led by Mr Arthur Yuen, Deputy Chief Executive of the Hong Kong Monetary Authority (HKMA). The Assessment Team comprised seven technical experts drawn from Australia, France, Germany, Malaysia, Mexico, South Africa and the United Kingdom. The LCR assessment was covered by two assessors from the Assessment Team (Annex 1). The main counterpart for the assessment was the Reserve Bank of India (RBI).

The assessment relied upon the information, data and materiality computations provided by the RBI by end-March 2015. The assessment findings are based primarily on an understanding of the current processes in India as explained by the counterpart staff and the expert view of the Assessment Team on the documents and data reviewed. The overall work was coordinated by the Basel Committee Secretariat with support from HKMA staff.

The assessment began in 2014 and consisted of three phases: (i) completion of an RCAP questionnaire (a self-assessment) by the RBI; (ii) an off- and on-site assessment phase (October 2014 to March 2015); and (iii) a post-assessment review phase (April to June 2015). The on-site visit included discussions with Indian counterparts and representatives of Indian banks. These exchanges provided the Assessment Team with a deeper understanding of the implementation of the Basel LCR standard in India. The third phase consisted of a two-stage technical review of the assessment findings: first, by a separate RCAP Review Team and feedback from the Basel Committee's Supervision and Implementation Group and, second, by the RCAP Peer Review Board and the Basel Committee. This two-step review process is a key instrument of the RCAP process to provide quality control and ensure integrity of the assessment findings.

The focus of the assessment was on the consistency and completeness of the domestic regulations in India with the Basel minimum requirements. Issues relating to prudential outcomes, adequacy of liquidity ratios of individual banks or the effectiveness of the Indian authorities' liquidity risk management were not in the scope of this RCAP assessment exercise.

Where domestic regulations and provisions were identified to be non-conforming with the Basel framework, those deviations were evaluated for their current and potential impact (or non-impact) on the reported liquidity ratios for a sample of internationally and regionally active Indian banks. Some findings were evaluated on a qualitative basis. The overall assessment outcome was based on the materiality of findings and the use of expert judgment. The assessment also identified areas for follow-up actions by the RCAP, which are listed in Annex 12.

The report has two sections and a set of annexes: (i) an executive summary with a statement from the Indian authorities on the material findings; (ii) the context, scope and methodology and the main set of assessment findings; and (iii) details of the deviations and their materiality along with other assessment-related observations.

The RCAP Assessment Team acknowledges the professional cooperation received from Indian counterparts throughout the assessment process. In particular, the team thanks the staff of the RBI for playing an instrumental role in coordinating the assessment exercise. The Assessment Team would also like to thank the representatives of Indian banks that provided data and information and who participated in a meeting to discuss some of the findings identified by the Assessment Team. The series of comprehensive briefings and clarifications provided by the Indian counterparts helped the RCAP assessors to arrive at their expert assessment. The Assessment Team is hopeful that the RCAP assessment exercise will contribute to the sound initiatives that have already been taken by the Indian authorities and to further strengthening the prudential effectiveness and full implementation of the recent reform measures in India.

Executive summary

The Indian framework for LCR requirements was issued in June 2014 through the publication of final Guidelines on the LCR, Liquidity Risk Monitoring Tools and LCR Disclosure Standards. The LCR applies to all scheduled commercial banking institutions (which comprise private sector banks, public sector banks and foreign banks) in India.

In October 2014 the Indian authorities completed an extensive self-assessment of their draft LCR rules as part of their preparation for the RCAP exercise. In its review of the Indian regulations and the self-assessment by the RBI, the RCAP Assessment Team identified a number of material variations in the LCR rules from the Basel framework. The Indian authorities used the RCAP findings to amend the rule to the extent feasible and consistent with Indian national interests. This has resulted in a significant strengthening of the Indian liquidity regime.

Overall, based on the current regulations, the final LCR requirements in India are assessed as Largely Compliant with the minimum Basel liquidity standards. The two graded components of the LCR framework, the LCR and the LCR disclosure requirements, are assessed as Largely Compliant and Compliant with the Basel standard, respectively.

Following the issuance of the amendments to the Indian LCR rule, one material finding remains with regard to the definition of high-quality liquid assets (HQLA), the numerator of the LCR. The RBI allows banks to include Indian State Government Securities, also known as State Development Loans (SDL), in the HQLA buffer. The Assessment Team reviewed the features of SDL and concluded that they cannot be considered as sovereign debt securities in the context of the Basel standard. The inclusion of SDL results in a material upward effect on the LCR that hampers its international comparability.

At same time, the team notes that the liquidity requirements for Indian banks are generally more conservative than the Basel standards. Since the 1940s Indian banks have been subject to the Statutory Liquidity Requirement (SLR), which requires them to hold a substantial portion of their assets in cash, gold, government securities and SDLs. The SLR is generally used for managing banking system liquidity. Following the implementation of the LCR, the RBI has decided to maintain the SLR to run in parallel with the LCR. The team has reviewed the interaction between the LCR and SLR and has concluded that the LCR of Indian Banks would be substantially higher if the RBI would allow Indian banks to include all securities that are held to comply with the SLR. At present, however, the RBI allows Indian banks to include only about a third of the securities held for the SLR. The Assessment Team is of the view that the RBI will allow Indian banks to monetise the assets under the SLR in private markets in times of need (see Section 2.3 for more details on the SLR requirement). The RBI explained that it considers it important to require banks to hold a large liquidity buffer as a matter of prudence. The RBI credits the SLR for playing an important role in protecting its banks from past liquidity crises.

The Indian authorities and banks now face the challenge of implementing the LCR standard in practice (see Annex 7 for the key liquidity indicators of the Indian banking system). The RBI has developed and implemented the necessary reporting templates and systems. However, while the focus of the RCAP exercise was mainly on the consistency and completeness of regulatory LCR requirements, the achievement of the intended prudential outcomes in India will depend on how effectively the regulations are put into practice, monitored and supervised. The interaction between the new LCR requirements and the existing liquidity requirements in India – the Statutory Liquidity Ratio (SLR) – warrants careful attention and review.

This report also summarises India's implementation of the Basel *Principles for sound liquidity risk management and supervision* (Sound Principles) and the LCR monitoring tools (Annexes 9 and 10).The Sound Principles have been implemented in India's regulation through the Guidelines on Liquidity Risk Management by Banks (2012). The liquidity monitoring tools are implemented in India in the Guidelines on Monitoring Tools (2014). Further, a summary is provided of the key national discretions and approaches that the Indian authorities have adopted in their implementation of the LCR standard (Annex 14).

These help to clarify how national authorities implement certain aspects of the Basel standards that are not in scope of the formal RCAP-LCR assessment at this point of time. Over time, the information detailed in the annexes to the report will provide a basis for designing best practices and additional supervisory guidance that will benefit the regulatory community and the banking industry to raise consistency of the implementation of the LCR and to improve the effectiveness in practice.

Looking ahead, the Assessment Team noted an item for post-RCAP follow-up or when another RCAP assessment is undertaken (Annex 12). This will help ensure that India effectively deploys its new LCR framework to supervise the Indian banking system and maintain financial stability. The team also identified an item that would benefit from further clarification by the Basel Committee (Annex 11). This concerns the treatment of state government exposures in the LCR.

Response from the Indian authorities

The Reserve Bank of India (RBI) appreciates the insights provided and level of professionalism shown by the Assessment Team throughout the assessment process under the leadership of Mr Arthur Yuen. The RBI welcomes the opportunity given to respond to the findings on the implementation of Basel framework in India.

The RBI generally agrees with the findings of this assessment report. However, one of the issues observed in the report is that state government securities, also known as State Development Loans (SDLs), should not be made eligible for inclusion in the Level 1 High-Quality Liquid Assets (HQLA). The Basel LCR rule text, however, allows sovereign securities issued in the domestic currency in the country in which the liquidity risk is being taken, or in the bank's home country, to be treated as Level 1 HQLA. Although the word sovereign, or sovereign-like treatment, is not defined in the Basel LCR rules text, it draws its definition from Basel capital framework as it links the definition of Level 1 assets with the risk weight assigned to such securities. Under the Basel capital framework (footnote 23 to paragraph 58 of the Basel II text), securities issued by regional governments/local authorities qualify for the same treatment as claims on their sovereign or central government if these governments and local authorities have specific revenue-raising powers and have specific institutional arrangements, the effect of which is to reduce their risk of default. Further, under the Basel LCR rule text (footnote 15 of paragraph 50 of the framework), when a 0% risk weight has been assigned at national discretion under Standardised Approach, the treatment of such securities should follow paragraph 50(d) or 50(e), which deals with the Level 1 assets where sovereign has a non-0% risk weight.

In India, the state governments are fiscal sovereigns, as the state governments derive powers from the Constitution of India that allow them to raise resources through taxation. In addition, the state governments also have a share in the tax collected by central government. Further, SDLs meet the fundamental and market-related characteristics for HQLA. SDLs are issued and traded in the markets very similar to that of central government securities. SDLs are also eligible as collateral for borrowing through repo and borrowing from the RBI's Liquidity Adjustment Facility. Accordingly, in our opinion, securities issued by the state governments in India qualify for the same treatment as claims on sovereigns and, therefore, they are eligible to be recognised as a Level 1 asset for LCR purposes, like government of India securities, under para 50(d) of the Basel LCR rule text. We are, therefore, of the opinion that SDLs should be considered as part of Level 1 HQLA.

The assessment has viewed the inclusion of SDLs in HQLA Level 1 assets as a material deviation. The reason advanced is that SDLs form a sizeable portion of banks' holdings of government securities. Of the total of INR 21.99 trillion government securities in India held by scheduled commercial banks (March 2014), only INR 4.60 trillion are state government securities. It may also be appreciated here that, since the 1940s, Indian banks have been subject to the Statutory Liquidity Requirement (SLR), which requires them to hold a substantial portion of their assets in cash, gold, government securities and SDLs, which are generally used for managing banking system liquidity. The liquidity requirements for Indian banks are thus more conservative than the Basel standards as the RBI presently allows Indian banks to include only about a third of the securities held for the SLR in HQLA Level 1 assets for LCR purposes, and no specific security within the pool of securities for SLR is earmarked as a HQLA Level 1 asset for computing the LCR. The impact assessment for determining materiality should, therefore, not assume which class of securities will be liquidated. Given the stance of the assessment towards the liquidity of SDLs, it would be logical for the team to therefore assume, based on its comments in the assessment, that the central government securities would be liquidated first. And since there is a more than adequate stock of central government securities, the impact analysis should be looking only at the availability of what the Assessment Team considers eligible and liquid, without making any pro rata deductions of SDLs on a hypothetical basis.

In fact, the available stock of eligible central government securities, at around 17% of NDTL, is more than double the amount (7% of NDTL) that RBI regulations reckon as HQLA Level 1. Therefore, even if, for argument's sake, the entire stock of SDLs is made ineligible for HQLA Level 1, the numerator of the LCR is not necessarily diminished in value as a consequence. Thus, disallowing SDLs should not lead to a material deviation.

It would also be unnecessary for the RBI to prescribe any hierarchy of eligibility for HQLA. The availability of what the Assessment Team considers as adequate eligible securities is all that matters, for the purpose of assessing materiality.

The Assessment Team has also observed that the market liquidity of SDLs is lower than that for central government securities, which is reflected in a higher liquidity risk premium, and viewed this as a further reason to disallow the inclusion of SDLs in the definition of HQLA as Level 1 assets, in the spirit of the fundamental and market-related characteristics of the LCR as specified by Basel. It may be mentioned here that in any jurisdiction, federal/state government securities will generally have lower market liquidity than the central government securities. However, the test for LCR is whether SDLs meet fundamental and market-related characteristics as specified by Basel or not. In our assessment, they meet all the required characteristics to the same degree as any sovereign securities.

Further, on the issue of materiality assessment assumptions, we do not agree with the assumptions made by the Assessment team. Under both the assumptions, the team has deducted the State Government Securities ie, the State Development Loans (SDL) on pro rata basis from the eligible stock of SLR for LCR, presuming that the SDL stock would compulsorily have to be liquidated in the same proportion in which they are held as part of the aggregate stock of SLR securities – in other words, admitting the availability of non-SDL securities, ie Govt. of India securities for liquidation on only a pro rata basis. The RCAP Assessment Team ignored the fact that, even assuming the complete stock of SDL is made ineligible for the purpose of LCR, Indian banks collectively and individually have more than sufficient HQLA to meet the LCR requirements.[1] In other words, even if the team would have removed the entire stock of SDLs (approx. 4% of NDTL) from L1 HQLA, the numerator of the LCR would not have diminished in value as a consequence. The correct test of materiality, in our view, should therefore be whether adequate SLR securities (considered "eligible" by the Assessment Team) in the aggregate pool of SLR securities held by the banks would be available for regulatory L1 HQLA after deducting in full the stock considered ineligible by the Assessment Team, from the aggregate pool.

The Assessment Team has considered the implementation of liquidity standards in India as largely compliant with the Basel framework, primarily due to deviation observed by the Assessment Team on the treatment of SDLs as Level 1 High-Quality Liquid Assets (HQLA). In view of the above explanation, we are of the opinion that the implementation of liquidity standards in India merits a compliant rating.

Based on the RBI's self-assessment and, as identified by the RCAP Assessment Team, the RBI has carried out certain modifications in the existing guidelines concerning the domestic implementation of Basel liquidity framework. RBI would like to thank the BCBS and the RCAP Assessment Team for the professionalism with which the entire RCAP process for India was completed. The RBI believes that the

[1] SDL are approx. only 20% of the total stock of government securities. With mandatory SLR at 21.5%, the available stock of eligible central government securities, at around 17% of NDTL, is more than double the amount (7% of NDTL) that RBI regulations reckon as L1 HQLA.

RCAP process promotes a level playing field among Basel member jurisdictions, reduces regulatory arbitrage and promotes global financial stability.

1 Assessment context and main findings

Status of implementation

In India, the Reserve Bank of India (RBI) is the monetary and banking authority as established by the Reserve Bank of India Act (RBI Act). The RBI is responsible for supervision and control of the banking sector under the provisions of the Banking Regulation Act, and supervises the Indian banks' adherence to the liquidity requirements.

The LCR requirements were issued in June 2014, with a minor update made in November 2014. Subsequently, on 31 March 2015, the Indian authorities issued further amendments to the LCR requirements, including those in disclosure requirements.

Along with the implementation of the LCR requirements, the Indian authorities have implemented the LCR monitoring tools and principles for sound liquidity risk management. A factual description of each of these frameworks is provided in Annexes 9 and 10, respectively.

Regulatory system and model of supervision

In India, all the scheduled commercial banks (excluding regional rural banks) fall under the purview of the RBI's Basel III regulations, which includes the LCR requirements.

The RBI Act provides broad powers to the RBI to issue circulars and directions to set banking supervision and to carry out inspections of any banks active in India. The RBI Act envisages action to be taken by the RBI, when the RBI is satisfied that circumstances warrant such action, to safeguard the interests of depositors, and the stability of individual banks and the country's banking system. All circulars, directions and guidelines issued by the RBI are legally binding inasmuch they have been issued by the RBI under the statutory powers vested in it by the RBI Act. The RBI can also impose fines for non-compliance with the requirements stipulated in its banking regulations.

1.2 Structure, enforceability and binding nature of prudential regulations

The Banking Regulation Act empowers the RBI to issue and amend banking regulations. All directions/guidelines/circulars issued by the RBI are binding. There is no hierarchy in the regulatory instruments; the nomenclature given to a particular communication by the RBI has no material impact on its enforceability.

The following table provides an overview of the prudential regulations in India (details on the structure and binding nature of prudential regulations in India are outlined in the RCAP assessment report on India's risk-based capital requirements for banks).[2] The LCR requirements issued by the RBI meet the RCAP criterion of being enforceable and binding in nature.

[2] Available at www.bis.org/bcbs/implementation/l2.htm.

Overview of Indian laws and regulatory instruments	Table 1
Level of rules (in legal terms)	Type
Reserve Bank of India Act, 1934, and Banking Regulation Act, 1949	The Act empowers the RBI to issue binding circulars/directions/guidelines to banks
RBI circulars and other guidelines	Guidelines issued by the RBI to banks are mandatory.

1.3 Scope of the assessment

The assessment was made of the LCR requirements as applicable to all scheduled commercial banks in India (excluding regional rural banks). In evaluating the materiality of the findings, the quantification was limited to the agreed 15 banks subject to the RCAP review (see Annex 8).[3] These banks hold approximately 60% of the assets in the Indian banking system.

Assessment grading and methodology

As per the RCAP methodology approved by the Basel Committee, the outcome of the assessment was summarised using a four-grade scale, both at the level of each of the two components of the Basel LCR framework (LCR and LCR disclosure requirements) and overall assessment of compliance: compliant, largely compliant, materially non-compliant and non-compliant.[4]

The materiality of the deviations was assessed in terms of their current or, where applicable, potential future impact (or non-impact) on the liquidity coverage ratios of the banks. Wherever relevant and feasible, the Assessment Team, together with the Indian authorities, attempted to quantify the impact based on data collected from Indian banks in the agreed sample of banks. The non-quantifiable aspects of identified deviations were discussed and reviewed with the Indian authorities, in the context of the prevailing regulatory practices and processes.

Ultimately, the assignment of the assessment grades was guided by the collective expert judgment of the Assessment Team. In doing so, the Assessment Team relied on the general principle that the burden of proof rests with the assessed jurisdiction to show that a finding is not material or not potentially material. A summary of the materiality analysis is given in Section 2 and Annex 8.

In a number of areas, notably the SLR, the Indian liquidity requirements go beyond the minimum Basel standards. Although these elements provide for a more rigorous implementation of the Basel framework in some aspects, they have not been taken into account for the assessment of

3 For practical purposes, data were generally collected from a subset of eight to 10 Indian banks out of the 15 banks in the RCAP sample. The banks were selected by the RBI based on the nature of the individual findings to include those banks where the issue was considered most relevant given the banks' exposures or business model. Where the RBI decided to rectify or amend the regulations, typically no data were collected for the materiality assessment. The entire sample of 15 banks covers approximately 60% of total assets of Indian commercial banks.

4 This four-grade scale is consistent with the approach used for assessing countries' compliance with the Basel Committee's *Core principles for effective banking supervision*. The actual definition of the four grades has been adjusted to take into account the different nature of the two exercises. In addition, components of the Basel framework that are not relevant to an individual jurisdiction may be assessed as not applicable (NA). For further details, see www.bis.org/publ/bcbs264.htm.

compliance under the RCAP methodology as per the agreed assessment methodology (see Annex 13 for a listing of areas of super-equivalence).

1.4 Main findings

A summary of the main findings is given below. Overall, the Assessment Team assesses the LCR regulation issued by the RBI to be largely compliant with the Basel standard. The components assessed by the RCAP Assessment Team (the LCR regulation and the LCR disclosure standards) are assessed respectively as largely compliant and compliant with the minimum Basel standard. More detail is provided in the main findings section below.

Summary assessment grading — Table 2

Key components of the Basel LCR framework	Grade
Overall grade:	LC
LCR subcomponents (as agreed by the Basel Committee in September)	
Liquidity Coverage Ratio regulation	LC
LCR Disclosure Standards	C

Compliance assessment scale (see Section 1.3 for more information on the definition of the grades): C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).

Main findings by component

Scope of application and transitional arrangements

The assessment team finds the scope of application and the transitional arrangements to be compliant with the Basel standard. Although the scope of application was originally at whole bank level only for all scheduled commercial banks (excluding regional rural banks), by 1 January 2016 the RBI will require banks to apply the LCR standard and the monitoring tools at a consolidated level. The minimum requirement will be phased in according to the schedule foreseen by the Basel standard, starting with a minimum requirement of 60% on 1 January 2015.

High-quality liquid assets (numerator)

The rules on high-quality liquid assets (HQLA) are a key element of the Basel LCR standard. The Basel rules on HQLA set out the characteristics of HQLA, define operational requirements for the management of a bank's stock of HQLA, require the stock of HQLA to be diversified and set out a list of assets which a national supervisor may recognise as HQLA. The RBI has implemented the HQLA component of the LCR, although with one key deviation from the Basel rules. The Assessment Team assesses the implementation of the HQLA requirement as being largely compliant.

The RBI regulations allow for obligations of state governments, namely State Development Loans (SDLs), to be recognised as a Level 1 asset, even though these are not explicitly allowed under Basel III LCR paragraph 50(d). The RBI has taken the view that the Constitution of India provides strong law-making and revenue-raising powers for states, to the extent that they can be deemed to be "fiscal sovereigns", thereby qualifying their state government securities to be recognised as a Level 1 asset. The RBI points out that the logic of treating PSEs as sovereigns under certain conditions is well entrenched in the Basel capital framework and should be extended to the LCR. The fact that the RBI is the debt manager and banker for states, and that SDLs are also eligible as collateral for borrowing through repo and borrowing from the RBI's Liquidity Adjustment Facility, have also been cited as reasons by the RBI for not distinguishing their treatment from that accorded to central government securities. The RBI has also pointed out that no state in India has ever defaulted on any loan obligation.

While the Basel rules are not entirely explicit on this issue, the Assessment Team maintains the view that, in the context of India, only the central government should be regarded as sovereign for the purpose of HQLA qualification. The team believes that the concept of a "sovereign", as conventionally understood by market participants and other practitioners (eg as exemplified by how credit ratings and bond indices are categorised) and as used in the Basel standard, suggests that state governments in India should not be regarded as "sovereign". For example, the Basel capital framework clearly cites "regional governments and local authorities" as being examples of PSEs, as distinct from sovereigns.

While SDLs are accepted as eligible collateral for borrowing via market repo as well as from the RBI's Liquidity Adjustment Facility (LAF), the team was informed by banks that the market liquidity of SDLs is lower than that for central government securities. This is reflected in a higher liquidity risk premium. The team views this as a further reason to disallow the inclusion of SDLs in the definition of HQLA as Level 1 assets, in the spirit of the fundamental and market-related characteristics of the LCR as specified by Basel.

In the light of these considerations, and in the context of this RCAP exercise, the Assessment Team takes the position that it does not view state government exposures as being "sovereign" for the purposes of the LCR. It nevertheless requests that the Basel Committee confirm this interpretation, at the conceptual level of whether state exposures can be regarded as "sovereign" in the context of HQLA calculation, to clear all doubt on this matter.

Following discussions with the Assessment Team, the RBI has also amended its rules to clarify requirements in a number of areas that were identified as gaps during the initial assessment. These include those in the areas of characteristics of HQLA, as well as the operational requirements and definition of HQLA. This is to ensure that only assets that can be truly relied upon to raise liquidity under a stress scenario are included as HQLAs.

A further issue in respect of the HQLA of the RBI regulations arises from the interactions of the LCR with the RBI's Statutory Liquidity Ratio requirement, and the treatment of its Marginal Standing Facility and Facility to Avail Liquidity for Liquidity Coverage Ratio. Banks in India are subject to the Statutory Liquidity Ratio (SLR) requirement. The RBI has chosen to continue to maintain the SLR as a matter of prudence even following the introduction of the LCR, resulting in effectively two separate prudential liquidity requirements running in parallel. A question therefore arises as to whether assets that are used to meet the SLR can also be recognised as HQLAs under the LCR. Unlike the LCR, there are no explicit provisions in the SLR guidelines and the Banking Regulation Act to suspend enforcement of the SLR in times of stress. Accordingly, government securities used for purposes of meeting the SLR should in principle not count toward the LCR. For this reason, the RBI allows for only a limited portion of government securities used to meet the SLR to be recognised as HQLA Level 1, to the extent permitted by its Marginal Standing Facility (MSF) and Facility to Avail Liquidity for Liquidity Coverage Ratio (FALLCR). The Assessment Team, however, does not take the view that the liquidity generated by these facilities will be sufficiently effective to be counted as Level 1 HQLA.

That said, the Assessment Team has concluded that these concerns are unlikely to be borne out in practice, as the SLR requirement does not fundamentally encumber assets in that it does not impede their monetisation in private markets in times of need. The RBI has, indeed, full authority to recalibrate the SLR requirement in times of stress, and to waive penalty charges for banks which do not comply with the SLR. In the team's view, it is reasonable to expect that the RBI would lower the SLR requirements or waive its penalties under such circumstances, as the RBI has indicated in discussions with the team that it considers the SLR as an instrument for controlling banking system liquidity, and that it would allow banks to use the buffer in times of stress (see also Section 2.3). Accordingly, in times of need, the SLR should not act as an obstacle to banks seeking to monetise their assets in private markets, and banks would therefore not need to rely solely on the MSF and FALLCR for liquidity. As such, the team concluded that this issue should be treated as an observation and not a finding.

Outflows (denominator)

The Basel standard specifies in detail the "run-off" factors that banks should apply to various types of liabilities and off balance sheet exposures. The RBI has implemented the requirements through the liquidity reporting template and the accompanying explanatory notes, both of which form part of the regulations. The Assessment Team assesses the implementation of the outflows requirement as being compliant.

Following discussions with the Assessment Team, the RBI has amended its rules to clarify requirements in a number of areas which were identified as gaps during the initial assessment. These include (i) retail term deposits, (ii) unsecured wholesale funding, (iii) secured funding, (iv) additional requirements, and (v) contractual obligations to extend funds within a 30-day period. A material gap concerning the definition of small business customers was also rectified as a result of these discussions.

Inflows (denominator)

The Basel standard specifies in detail the inflow factors that banks should apply to various types of assets. The RBI has implemented the requirements through the liquidity reporting template and the accompanying explanatory notes, both of which form part of the regulations. The Assessment Team assesses the implementation of the inflows requirement as being compliant.

Following discussions with the Assessment Team, the RBI has amended its rules to clarify requirements in a number of areas which were identified as gaps during the initial assessment. These include (i) secured lending, (ii) other inflows by counterparties, (iii) inflows from securities maturing within 30 days not included in the stock of HQLA, (iv) derivatives collateralised by HQLA, (v) non-financial revenues, and (vi) inflows from operational deposits. A rectification was also made to clarify the requirement for banks to monitor the concentration of expected inflows across wholesale counterparties.

Disclosure requirements

Basel requires disclosure of the LCR at consolidated level and at the same frequency, and concurrently with, the publication of financial statements. The Indian regulation is compliant with this requirement. In compliance with Basel, the RBI requires banks to calculate simple averages of monthly calculations until the financial year ending March 2017, and from then on to calculate the simple average based on daily observations.

2 Detailed assessment findings

The component-by-component details of the assessment of compliance with the liquidity standards of the Basel framework are detailed below. The focus of Sections 2.1 to 2.3 is on findings that were assessed to be deviating from the Basel minimum standards and their materiality. Section 2.4 lists some observations and other findings specific to implementation practices in India.

2.1 LCR

Section grade	Largely compliant
Summary	Overall, the Assessment Team assesses the current Indian regulations adopting the LCR requirements as largely compliant. Several findings have been identified which are detailed below.

2.1.1 Scope of application and transitional arrangements

Summary	The Assessment Team finds the Indian scope and the transitional arrangements to be compliant with the Basel standards. The LCR was introduced in India on 1 January 2015 for all scheduled commercial banks following the phase-in arrangement allowed under Basel. From 1 January 2016 onwards, application will move to the consolidated level.

2.1.2 High-quality liquid assets (numerator)

Summary	The Assessment Team assesses India's regulatory implementation of the HQLA requirements to be largely compliant at present. A key deviation is the recognition of state government securities as HQLA. The Assessment Team also considered the issue of the Statutory Liquidity Ratio requirement in India, which runs in parallel with the LCR, to assess whether assets used to meet the SLR would be deemed as being "encumbered" and therefore not available for use under the LCR. The Assessment Team concluded that the design and implementation of the SLR allows banks full use of such assets for the purposes of the LCR.
Basel paragraph no	Basel III LCR paragraph 50
Reference in domestic regulation	Regulation 1 paragraph 5.4
Findings	*Definition of HQLA – State Development Loans* The RBI regulations allow for obligations of state governments, namely State Development Loans (SDLs), to be recognised as a Level 1 asset. As India is not a 0% risk weight jurisdiction, government securities are recognised as Level 1 assets pursuant to Basel III LCR paragraphs 50(d) and 50(e), and not Basel III LCR paragraph 50(c). Basel III LCR paragraphs 50(d) and (e) only allow securities issued by sovereigns (and central banks), which in the context of India, the Assessment Team views as referring only to the central government of India, and not to the state governments (note: the RBI does not issue debt securities). The RBI has pointed out that nowhere in the Basel framework is a definition of the term "sovereign" provided. In the absence of a definition of "sovereign" in the Basel rules, the RBI points out that consideration should be given for state governments in India to be deemed as such under the LCR, given their law-making and revenue-raising powers under the Constitution of India. The Constitution also provides state legislatures with exclusive power to make laws regarding the public debt of states. The RBI also highlights that the capital framework (footnote 23 to paragraph 58 of the Basel II text) allows PSEs such as state governments in India to qualify for the same treatment as claims on sovereigns if these PSEs have specific revenue-raising powers

	and have specific institutional arrangements the effect of which is to reduce their risks of default (the RBI's capital framework allows for these obligations to be 0% risk-weighted).The RBI argues that this logic should be extended to the LCR, thereby allowing SDLs to be recognised as a Level 1 asset in the same way as central government securities. In addition, the RBI further argues that the SDLs meet the fundamental and market-related characteristics for HQLA. While the market for SDLs is not as deep and active as that for central government securities, SDLs are issued in and traded on markets very similar to that for central government securities. The RBI is the debt manager and banker for states, and SDLs are also eligible as collateral for borrowing through repo and borrowing from the RBI's Liquidity Adjustment Facility. The RBI has also pointed out that no state has ever defaulted on any loan obligation. While the Assessment Team acknowledges that the Basel LCR rules do not explicitly preclude state governments from being deemed as sovereigns, and notes the interpretation that the RBI has taken on this matter, it maintains the view that in the context of India, only the central government should be regarded as sovereign for the purpose of HQLA qualification. The Team believes that the concept, as conventionally understood by market participants and other practitioners (eg as exemplified by how credit ratings and bond indices are categorised) and as used in the Basel standard itself suggests that state governments in India are *not* sovereign. For example, the capital framework (also in footnote 23 to paragraph 58 of the Basel II text) clearly cites "regional governments and local authorities" as being examples of PSEs, as distinct from sovereigns. In the Assessment Team's discussion with the industry, it was also confirmed that the liquidity of SDLs is much lower than that of Indian sovereign debts, and such exposures are therefore traded with a liquidity premium. In the light of these considerations, the Assessment Team does not view state governments as being "sovereign" for purposes of the LCR, and requests that the Basel Committee confirms this interpretation as a conceptual issue of whether state exposures could be regarded as "sovereign" for the purpose of LCR under certain circumstances. (Note: State Development Loans are, in fact, not loans but securities issued through an auction similar to that conducted for securities issued by the central government. SDLs are also eligible as collateral for borrowing through repo and the under the RBI's Liquidity Adjustment Facility.)
Materiality	Material. SDLs form a sizeable portion of banks' holdings of government securities. Of the INR 22 trillion in government securities held by scheduled commercial banks in India (March 2014), INR 4.6 trillion are state government securities. The team analysed different scenarios to assess the potential impact of SDLs on the LCR ratio. Depending on the assumptions used, the team calculates that the average LCR could potentially be overstated by approximately 6 to 14 %-points if these state government securities are recognised. For individual banks, the impact will depend on the amount of holdings of SDLs and the allocation of SDLs between the SLR and the LCR.

2.1.3 Outflows (denominator)

The rectifications issued by the RBI on 31 March 2015 resolved all identified deviations regarding outflows.

2.1.4 Inflows (denominator)

The rectifications issued by the RBI on 31 March 2015 resolved all identified deviations regarding inflows.

2.2 LCR disclosure requirements

Section grade	Compliant
Summary	The LCR disclosure requirements are compliant with the Basel rules. The disclosure

	format introduced by the RBI is identical with that published by Basel. The RBI has made use of the possibility to allow calculation on the basis of monthly averages during a transitional period until March 2017 (first reporting period after January 2017).

2.3 Observations

The following list includes observations made by the Assessment Team regarding India's implementation of the LCR standard. These observations are assessed as consistent with the Basel standard and are provided here for background information only.

Basel paragraph no	Basel III LCR paragraphs 50 and 54a
Reference in domestic regulation	Regulation 1 paragraphs 5.4 and 5.5
Observation	*Definition of HQLA – Interactions with the Statutory Liquidity Ratio requirement, and the treatment of the Marginal Standing Facility and Facility to Avail Liquidity for Liquidity Coverage Ratio* Banks in India are subject to the Statutory Liquidity Ratio (SLR) requirement, pursuant to Section 24 of the Banking Regulation Act 1949. While the SLR serves as a prudential requirement in the same way as the LCR to ensure that banks have adequate liquidity buffers to withstand large withdrawals, the RBI has chosen to continue to maintain the SLR as a matter of prudence even following the introduction of the LCR. Under the SLR, banks are required to maintain at all times certain prescribed assets, the value of which shall be no less than that determined by the RBI (at the time of writing of this report, 21.5%[5] of a bank's "Net Demand And Time Liabilities" or NDTL[6]). Prescribed assets include cash, gold and government securities. Non-compliance with the SLR attracts monetary penalties. Unlike the LCR, there are no explicit provisions in the SLR guidelines and the Banking Regulation Act to suspend enforcement of the SLR in times of stress. Accordingly government securities used for the purposes of meeting the SLR should *in principle* not be counted to meet the LCR. It should be noted that the RBI allows for only a limited portion of government securities used to meet the SLR to be recognised as HQLA Level 1 through two liquidity facilities: • Up to 2% of a bank's NDTL as allowed under the RBI's Marginal Standing Facility (MSF); and • A further 5% of bank's NDTL as allowed under the "Facility to Avail Liquidity for Liquidity Coverage Ratio" or "FALLCR", a specially created facility to allow banks to draw on liquidity under the LCR. The use of these facilities would not attract a penalty that would otherwise have to be paid as a result of non-compliance with the SLR caused by the monetisation of assets through outright sale or private repo transactions. The use of these facilities therefore

5 Last changed on 7 February 2015.

6 The NDTL has been defined by the RBI to include all demand deposits (eg current deposits, demand liabilities portion of savings bank deposits) and time deposits (eg fixed deposits, cash certificates) or borrowings or other miscellaneous items of liabilities, but not including liabilities such as paid-up capital and reserves.

	allows banks to receive liquidity from the RBI, while continuing to have their government securities pledged to count towards the SLR. The Assessment Team does not believe that the liquidity generated by these facilities will be sufficiently effective to be counted as Level 1 HQLA for a number of reasons: • Liquidity may only be generated by pledging these securities to the RBI, but not to private markets. This runs counter to the spirit of the LCR which aims to discourage overreliance on central banks to provide liquidity in times of stress. • The amount recognised in the RBI LCR regulations is the market value of the securities, and not the value of the liquidity that can be generated from the facility (ie the undrawn amount of the facility which is the market value of collateral less a haircut). • The FALLCR appears to be constituted as a "contractual committed liquidity facility (CLF) provided by a central bank", and should therefore be subject to a commitment fee and, if at all, be recognised only as a Level 2B asset as required under the Basel rules (Basel LCR paragraph 54a). Recognition of the facility as a Level 1 asset may be possible, but only under the ALA framework for which India has not applied. It should also be noted that recognition as a Level 2B asset is reinforced by the condition stipulated by the RBI that a bank may only use the FALLCR after all of its other HQLA are exhausted first. Notwithstanding the above considerations, concerns of liquidity generated by the MSF and FALLCR being of inadequate quality are unlikely to be borne out in practice as, more fundamentally, the SLR requirement does not really encumber assets in that it does not impede their monetisation in private markets in times of need : • The RBI, as the central bank, has full power over the SLR. As the RBI regards the SLR as an instrument to control banking system liquidity, it is likely to respond to a liquidity crisis by adjusting the SLR requirement accordingly. In theory, any lowering of the SLR can be implemented immediately, although, as a matter of practice, policy changes are announced in the RBI's Bimonthly Monetary Policy Statements issued six times a year. Conversations with a number of banks indicated that banks believe that the RBI would reduce the SLR requirement if needed in times of a systemic liquidity stress. • By introducing the facilities, the RBI has demonstrated it is prepared to allow usage of SLR assets during an LCR stress event without applying a penalty. • Where the RBI does not lower the SLR for the entire banking system, the consequences to an individual bank for not complying with the SLR are not material, as the bank would need only to pay a penalty interest rate to the RBI. This would not be a strong enough deterrent to dissuade banks from tapping into this pool of assets as source of liquidity in times of need. As such, banks should in theory be able to monetise government securities used for meeting the SLR, albeit at a higher cost. • Furthermore, Section 24(8) of the Banking Regulation Act 1949 gives the RBI discretion to waive the penal interest charges if it is satisfied with written explanations furnished by the banks for any non-compliance. Discussions with RBI staff confirm that the RBI would likely act in this way during a liquidity stress event, just as they would allow banks to do so for the LCR. Therefore, the Assessment Team has concluded that this issue should be treated as an observation and not a finding. Nevertheless, the Assessment Team recommends that the RBI provide greater clarity on the enforcement of the SLR in a liquidity stress scenario, in a similar way to the enhancements made to the Basel LCR rules in order to clarify how banks could be permitted to use their HQLA stock in times of stress (Basel III LCR paragraph 18).

Annexes

Annex 1: RCAP Assessment Team and Review Team

Assessment Team Leader

Name	Affiliation
Mr Arthur Yuen	Hong Kong Monetary Authority

Assessment Team Members

Name	Affiliation
Mr Philippe Durand	French Prudential Supervision and Resolution Authority
Ms Verónica Flores	Comisión Nacional Bancaria y de Valores (CNBV)
Mr Jacques Henning	South African Reserve Bank
Mr Roy Lim	Central Bank of Malaysia
Ms Isabel Mailly	Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)
Mr Kevin Ryan	Bank of England/Prudential Regulation Authority
Ms Raman Sandhu	Australian Prudential Regulation Authority

Supporting members

Name	Affiliation
Mr Noel Sacasa	Hong Kong Monetary Authority
Ms Carita Wan	Hong Kong Monetary Authority
Mr Maarten Hendrikx	Basel Committee Secretariat

Review Team

Name	Affiliation
Mr Georg Bulsink (SIG)	The Netherlands Bank
Mr Karl Cordewener	Basel Committee Secretariat
Mr Piers Haben (SIG)	European Banking Authority
Mr Lim Tuang Lee (PDG)	Monetary Authority of Singapore

Annex 2: List of LCR standards under the Basel framework used for the assessment

Basel documents in scope of the assessment

(i) The Liquidity Coverage Ratio (January 2013), including the frequently asked questions on Basel III's January 2013 Liquidity Coverage Ratio (April 2014);

(ii) Liquidity Coverage Ratio disclosure standards (January 2014);

Basel documents reviewed for information purposes

(iii) Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools (January 2013) (part on liquidity risk monitoring tools);

(iv) Monitoring tools for intraday liquidity management (April 2013); and,

(iv) Principles for sound liquidity risk management and supervision (September 2008).

Annex 3: Local regulations issued by Indian authorities for implementing Basel LCR standards

Overview of issuance dates of important Indian capital rules — Table 3

Domestic regulations	Name of the document, version and date
Implementation of the LCR	Basel III Framework on Liquidity Standards – Liquidity Coverage Ratio (LCR), Liquidity Risk Monitoring Tools and LCR Disclosure Standards DBOD.BP.BC.No.120 / 21.04.098/2013-14 dated 9 June 2014
Implementation of the LCR	Basel III Framework on Liquidity Standards – Liquidity Coverage Ratio (LCR), Liquidity Risk Monitoring Tools and LCR Disclosure Standards DBR.BP.BC.No.52/21.04.098/2014-15 dated 28 November 2014
Implementation of liquidity risk management regulations	Liquidity Risk Management by Banks DBOD.BP.No.56/21.04.098/2012-13 dated 7 November 2012

Hierarchy of Indian laws and regulatory instruments — Table 4

Level of rules (in legal terms)	Type
Reserve Bank of India Act, 1934 and Banking Regulation Act, 1949	Statutes which empower the RBI to issue directions/guidelines to banks.
All RBI circulars	Guidelines issued by the RBI to banks are mandatory.

Annex 4: Details of the RCAP assessment process

A. Off-site evaluation

(i) Completion of a self-assessment questionnaire by Indian authorities

(ii) Evaluation of the self-assessment by the RCAP Assessment Team

(iii) Independent comparison and evaluation of the domestic regulations issued by the Indian authorities with the corresponding Basel III standards issued by the BCBS

(iv) Identification of observations

(v) Refinement of the list of observations based on clarifications provided by Indian authorities

(vi) Assessment of the materiality of deviations for all quantifiable deviations based on data and non-quantifiable deviations based on expert judgment

(vii) Forwarding of the list of observations to Indian authorities

B. On-site assessment

(viii) Discussion of individual observations with Indian authorities

(ix) Meeting with selected Indian banks, accounting firms and a credit rating agency

(x) Discussion with Indian authorities and revision of findings to reflect additional information received

(xi) Assignment of component grades and overall grade

(xii) Submission of the detailed findings to Indian authorities with grades

(xiii) Receipt of comments on the detailed findings from Indian authorities

C. Review and finalisation of the RCAP report

(xiv) Review of comments by the RCAP Assessment Team, finalisation of the draft report and forwarding to Indian authorities for comments

(xv) Review of Indian authorities' comments by the RCAP Assessment Team

(xvi) Review of the draft report by the RCAP Review Team

(xvii) Review of the draft report by the Peer Review Board

(xviii) Reporting of findings to SIG by the team leader

Annex 5: List of rectifications by Indian authorities

Basel Paragraph	Reference to Indian document and paragraph	Brief description of the forthcoming correction
LCR calculation		
24–44, 52–54	Regulation 1 paras 5.1–5.8	The RBI enhanced the regulation to detail the requirements concerning the characteristics of HQLA, operational requirements and diversification of the stock of HQLA in line with the Basel LCR rules. These include clarifications concerning: • the essential fundamental and market-related characteristics of HQLA, and in particular not requiring that HQLA should have "low volatility" (Basel III LCR paragraph 24); • the objectives that banks should strive toward when monetising assets (Basel III LCR paragraph 30); • the definition of an "unencumbered" asset, which has a specific definition under the LCR (Basel III LCR paragraph 31); • the function which should have continuous and legal and operational capability to monetise an asset (Basel III LCR paragraph 33); • the requirement that outflows from early closeout of hedges should be reflected in the calculation of the HQLA, and not outflows (Basel III LCR paragraph 34); • the manner in which a bank should monitor the legal entity and physical location where collateral is held and how it may be mobilised in a timely manner (Basel III LCR paragraph 35); • the need for banks to take into account the risk that their ability to swap currencies and access relevant FX markets may be eroded rapidly under stressed conditions, and the need for them to be aware of the impact of sudden adverse exchange rate movements (Basel III LCR paragraph 42); • the requirement that Level 1 assets (particularly that of foreign sovereigns which the Basel rules do not exempt from the concentration limit) should be well diversified (Basel III LCR paragraph 44); • the requirement for banks to have appropriate systems and measures to monitor and control the potential risks (eg credit and market risks) that banks could be exposed to in holding Level 2B assets (Basel III LCR paragraph 53); and • the specific requirements for each Level 2 asset (ie that they should have a proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions).
48, Annex 1	Regulation 1 par. 6.3, 6.4 and 6.5	The RBI newly introduces the unwinding of collateral swap transactions (not allowed in India but to be considered under consolidated application) and unwinding of any Level 2 and 2B repo/reverse repo (formerly limited to the unwinding of transactions involving corporate bonds, currently the only Level 2 asset allowed in secured transactions in India). The RBI also introduces the differentiation between transactions involving HQLAs meeting the operational requirements and

		those that do not.
50	Regulation 1 para 5.4	The RBI enhanced the regulation to disallow securities guaranteed by non-0% risk weight foreign sovereigns to be recognised as HQLA.
82–84	Regulation 1, Explanatory Note (i) to BLR-1	The RBI clarified the cash outflows treatment for banks that waive their rights to allow for premature withdrawals of retail term deposits (such as that when a bank needs to do so for reputational reasons).
85	Regulation 1, Explanatory Note (iv) to BLR-1	The RBI aligned the definition of "unsecured wholesale funding" to be closer in line with the Basel LCR definition.
90	Regulation 1, Explanatory Note (v) to BLR-1	The RBI redefined the scope of entities eligible to be deemed as "small business customers" by lowering the total aggregate funding threshold to INR 50 million, in compliance with the €1 million threshold stipulated under the Basel LCR rules.
93–103	Regulation 1, Explanatory Note (vi) to BLR-1	The circumstances where a deposit can qualify as an "operational deposit" which enjoys a preferential run-off rate of 25% were further clarified by the RBI, particularly in respect of: • detailing the conditions when the (eg substantive dependency by customer, requirement for supervisory approval) preferential run-off rate may apply; and • defining "clearing", "custody" and "cash management" activities, ie activities which qualify as "operational deposits".
111–113	Regulation 1, Explanatory Note (vii) to BLR-1	The definition of "secured funding" was expanded to further clarify the scope of transactions covered under this item.
118–131	Regulation 1, Explanatory Notes (ix) to (xx) to BLR-1	Further explanatory notes to define clearly the circumstances in which additional cash outflows apply, and/or the item to which the factors should apply were provided.
155	Regulation 1, Explanatory Note (xxi)	The RBI amended the regulation to specify the treatment for inflows from securities maturing within 30 days not included in the stock of HQLA.
159	Regulation 1, Explanatory Note (xxii)	The RBI amended the regulation to specify the treatment for cash inflows arising from derivatives collateralised by HQLA.
160	Regulation 1, Explanatory Note (xxiii)	The RBI amended the regulation to specify the treatment for other contractual cash inflows, particularly in respect of the treatment of non-financial revenues.
143	Regulation 1, Explanatory Note (xxiv)	The RBI amended the regulation to require banks to monitor the concentration of expected inflows across wholesale counterparties.
151–152	Regulation 1, Explanatory Notes (xxv) and (xxvi)	The RBI amended the regulation to clarify the treatment of cash inflows arising from revolving facilities and loans with no specific maturity.
162	Regulation 1 para 2	Basel III LCR paragraph 162 requires the LCR to be monitored on an ongoing basis.
164	Regulation 1 para 3	Basel requires the LCR standard and the monitoring tools to be applied to all internationally active banks on a consolidated basis. While the Indian regulation originally applied the LCR at whole bank level only, from 1 January 2016 onwards application will be required at consolidated level.

169	Para 3 and Appendix III	Basel requires the adoption of home parameters for the calculation of the consolidated LCR. The RBI newly introduces this requirement alongside the introduction of LCR application at the consolidated level.
170	Para 3 and Appendix III	Deviating from the general rule in paragraph 169, Basel requires the application of host parameters for retail/small business deposit outflows, in the case where host parameters are stricter than home parameters. The RBI newly introduces this requirement alongside the introduction of LCR application at the consolidated level.
LCR disclosure requirements		
9, 12	Regulation 1 para 3	Basel requires the LCR disclosure standard and the monitoring tools to be applied to all internationally active banks on a consolidated basis. While the Indian regulation originally applied the LCR and the respective disclosure at whole bank level only, from 1 January 2016 onwards application will be required at the consolidated level.
10	Regulation 1 para 9.1.	Basel requires the LCR to be disclosed at the same frequency as, and concurrently with, the publication of banks' financial statements. The RBI required disclosure with the annual financial statements, precluding more frequent disclosure. RBI has rectified the rules text accordingly.
13	Regulation 1 para 9.2	The RBI introduced the requirement to publish the number of data points used for calculating average figures.

Annex 6: Assessment of bindingness of regulatory documents

The following table summarises the assessment of the seven criteria used by the Assessment Team to determine the eligibility of Indian regulatory documents.

Criterion	Assessment
(1) The instruments used are part of a well defined, clear and transparent hierarchy of legal and regulatory framework.	Yes. The Reserve Bank of India (RBI) is an autonomous body created under the Reserve Bank of India Act, 1934. It is entrusted, inter alia, with the responsibility for the regulation and supervision of banks under the Banking Regulation Act, 1949. The Banking Regulation Act (BR Act) provides the basic prudential framework including licensing, business activity, capital, liquidity management, governance, penal provisions, winding up and liquidation of non-viable banks. The RBI is also vested with broad powers under Sections 35A and 36 of the BR Act to issue guidelines to banking companies in general or to any banking company in particular on any issue relating to the functioning of banks if it is satisfied that these are required. The RBI has laid out mandatory prudential guidelines and norms for the sound management of banks, liquidity management, capital adequacy, income recognition, asset classification and provisioning, connected lending, large exposures, securitisation, derivatives and risk management. The powers conferred by the BR Act ensure that the RBI can enforce compliance with the provisions of the Act. The guidelines issued by RBI to banks are thus based on clear legal authority provided to RBI by Banking Regulation Act, 1949. All directions/guidelines/circulars issued by the RBI are legal inasmuch they have been issued by the RBI under the statutory powers vested in it by the BR Act, in the public interest, to safeguard the interests of depositors, as well as the stability of individual banks and the country's banking system.
(2) They are public and easily accessible.	Yes. Guidelines issued by RBI are available on the RBI website and can be accessed by anybody. Links to guidelines reviewed by RCAP team are provided in Annex 3.
(3) They are properly communicated and viewed as binding by banks as well as by the supervisors.	Yes. As stated earlier, prudential guidelines issued to banks by the RBI are based on powers vested in it by the BR Act and thus are viewed as binding by all concerned.
(4) They would generally be expected to be legally upheld if challenged and are supported by precedent.	Yes. As stated earlier, the prudential guidelines issued to banks by the RBI are based on the authority provided by BR Act and thus have been upheld by the courts on numerous occasions.
(5) Consequences of failure to comply are properly understood and carry the same practical effect as for the primary law or regulation.	Yes. Section 27 of the BR Act authorises the RBI to obtain information from banking companies, and Sections 35 and 22, empower the RBI to access the records/staff of banking companies, or provide for appropriate access on the part of the RBI to information in order to review compliance with internal rules and limits, as well as with external laws and regulations. More specifically, Section 35(2) of the BR Act gives the RBI access to every director, office or employee of a banking company and requires these persons to provide the RBI with any statements or information the RBI examiners may require. The RBI has also the power under Section 35A of the BR Act to issue directives to banking companies. The BR Act in Sections 46 and 47 authorises the RBI to take action against banking companies that fail to

		comply with the provisions of the BR Act, including the imposition of monetary penalties and the potential for criminal liability. Section 22(4) authorises the RBI to cancel the license of a banking company. The RBI has, therefore, sufficient legal powers to ensure compliance with its guidelines. The RBI thus has sufficient powers to ensure compliance with the prudential framework issued by the RBI.
(6)	The regulatory provisions are expressed in clear language that complies with the Basel provisions in both substance and spirit.	Yes.
(7)	The substance of the instrument is expected to remain in force for the foreseeable future	Generally yes. However, RBI's rules and regulations are modified/changed depending on changes made in international standards and also due to the needs of the situation.

Annex 7: Key liquidity indicators of Indian banking system

Size of banking sector (INR billions). Data as of September 2014		
1. Total assets all banks operating in the jurisdiction	117,621	
2. Total assets of all major locally incorporated banks	106,307	
3. Total assets of locally incorporated banks to which liquidity standards under the Basel framework are applied	106,307	
Number of banks		
4. Number of banks operating in the jurisdiction	90	
5. Number of Global Systemically Important Banks (G-SIBs)	No Indian headquartered bank has been designated as a G-SIB. However, many of the G-SIBs have presence in India in the form of branches.	
6. Number of Domestic Systemically Important Banks (D-SIBs)	Yet to be determined	
7. Number of major locally incorporated banks	47	
8. Number of banks required to implement Basel III liquidity standards	90	
9. Number of banks required to implement domestic liquidity standards	90	
Implementation of liquidity standards under the Basel framework	Unweighted	Weighted
10. Total HQLA	8,436	8,247
11. Level 1 HQLA	7,498	7,498
12. Level 2A HQLA	800	680
13. Level 2B HQLA	138	69
14. ALA HQLA	Not applicable	Not applicable
15. Total cash outflows	95,390	19,082
16. Retail and small business stable deposits	10,661	533
17. Retail and small business less stable deposits	34,572	3,457
18. Wholesale operational deposits	2,552	608
19. Wholesale unsecured non-operational funding	18,865	10,247
20. Secured funding	1,022	127
21. Debt issued instruments	NA	NA
22. Other contractual outflows	7,853	3,117
23. Contingent funding obligations	19,865	993
22. Total cash inflows	9,761	6,956
23. Secured lending	525	5
24. Fully performing unsecured loans	5,441	3,584
25. Other cash inflows	3,795	3,367
26. Liquidity Coverage Ratio		67.3%

Annex 8: A summary of the materiality assessment

As a general principle, and mirroring the established RCAP assessment methodology for risk-based capital standards, the RCAP-LCR materiality assessment is based on both quantitative and qualitative information with the overlay of expert judgment. Where possible, teams also take into account the dynamic nature of liquidity risks and seek to assess the materiality of any deviation at different points in time.

In line with underlying RCAP principles, the quantitative materiality assessment for the LCR is based on a determination of the cumulative impact of all identified deviations (both quantifiable deviations and non-quantifiable deviations). Where deviations are quantifiable, the Assessment Team will generally base the assessment on the highest impact that has been reported across three data points. The collection of data across different dates is agreed upon between the team leader and the assessed jurisdiction.

In the case of the Indian LCR assessment, one quantifiable deviation was assessed taking into account the amendments made by the Indian authorities during the course of the RCAP. The following table summarises the number of deviations according to their materiality.

Number of gaps / differences by component

Table 5

Component	Non-material	Material	Potentially material
Scope of application	0	0	0
Transitional arrangements	0	0	0
Definition of HQLA (numerator)	0	1	0
Outflows (denominator)	0	0	0
Inflows (denominator)	0	0	0
LCR disclosure requirements	0	0	0

Note: materiality is defined based on quantitative benchmark thresholds (for the quantifiable gaps) and expert judgment (for the non-quantifiable gaps). See Section 2 with the detailed assessment findings for further information.

RCAP sample of banks

The following Indian commercial banks were selected for materiality testing of the quantifiable deviations. Together these banks represent approximately 60% of the total assets of the Indian banking system (March 2014). Given the structure of the Indian banking system and its low concentration rate, it was agreed that, for individual data requests, the RBI would select eight to 10 banks from the 15 banks in the sample to provide data for materiality testing purposes. The selection was based on the nature of the issue and includes those banks where the issue was most relevant given their exposures or business models.

1 State Bank of India

2 Punjab National Bank

3 ICICI Bank Ltd

4 HDFC Bank Ltd

5	Canara Bank
6	Bank of Baroda
7	Bank of India
8	Axis Bank Ltd
9	Union Bank of India
10	IDBI Bank Ltd
11	Central Bank of India
12	Indian Overseas Bank
13	Corporation Bank
14	Oriental Bank of Commerce
15	Syndicate Bank

Annex 9: India's implementation of the liquidity monitoring tools

In addition to the minimum standard for the LCR, the Basel LCR framework also outlines the metrics to be used to monitor liquidity risks ("the monitoring tools"). The monitoring tools capture specific information related to a bank's cash flows, balance sheet structure, available unencumbered collateral and certain market indicators. The monitoring tools supplement the LCR standard and are a cornerstone for supervisors in assessing the liquidity risk of a bank. This annex provides a qualitative overview of the implementation of the monitoring tools in India.

Method of implementing the Basel liquidity monitoring tools

In conformity with the Basel rules text *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools* (January 2013), the RBI's guidelines on Liquidity Risk Monitoring Tools were issued together with the guidelines on the Liquidity Coverage Ratio (LCR) via the circular DBOD.BP.BC.No.120/21.04.098/2013-14 dated 9 June 2014. However, it may be mentioned here that the RBI had prescribed certain monitoring tools for liquidity risk since 1999. These tools included (a) the "Statement of structural liquidity", to capture the maturity structure of the cash inflows and outflows, and (b) the "Statement of short-term dynamic liquidity", which requires banks to monitor their liquidity on a dynamic basis over a time horizon spanning one to 90 days. These tools have evolved during this period and were reviewed in 2007 and 2012.

A list of the monitoring tools prescribed in the BCBS January 2013 document and the corresponding monitoring tools prescribed by the RBI is given below:

	BCBS monitoring tool	Corresponding RBI monitoring tool	Details of latest relevant circular	Effective since	Frequency of submission to RBI
1.	Contractual maturity mismatch	Statement of structural liquidity	Liquidity Risk Management by Banks, DBOD.BP.No.56/21.04.098/2012-13 dated 7 November 2012	1 April 1999	Fortnightly
2.	Concentration of funding	Statement of funding concentration	Basel III Framework on Liquidity Standards – Liquidity Coverage Ratio (LCR), Liquidity Risk Monitoring Tools and LCR Disclosure Standards DBOD.BP.BC.No.120 / 21.04.098/2013-14 dated 9 June 2014	30 September 2014	Monthly
3.	Available unencumbered assets	Statement of available unencumbered assets	as above	30 September 2014	Quarterly
4.	LCR by significant currency	Statement on LCR by significant currency	as above	30 September 2014	Monthly
5.	Market-related monitoring tools	Statement on other information on liquidity	as above	30 September 2014	Monthly

How are the tools used by supervisors?

Banks are required to calculate the parameters prescribed in the monitoring tools as part of their liquidity risk management process and practices. They are also required to regularly report these monitoring tools to the RBI's Department of Banking Supervision at a prescribed frequency and within a given time frame. Systems and procedures for preparation of these tools, authenticity of the data input, involvement of senior management etc are examined by the RBI during the on-site supervisory exercise of banks. RBI periodically analyses these tools to monitor the mismatches arising from maturities of banks' assets and liabilities, concentration of funding sources, amount of unencumbered assets, LCR by significant currencies and market information on banks' equity and debt prices. The reporting of inaccurate information, delays in submitting such returns or failure to submit them invite supervisory action.

How monitoring tools have been implemented in the Indian regulation

I. Contractual maturity mismatch

In this regard, the RBI requires banks to submit a "Statement of structural liquidity" (SSL) in two parts, namely Part A – Domestic Operations – and Part B – Overseas Operations.

Further, Part A is prepared separately for Domestic Currency, Indian Operations (Part A1); Foreign Currency, Indian Operations (Part A2); and Combined Indian Operations – Domestic and Foreign Currency. Part A2 is completed for four major currencies namely the US dollar, pounds sterling, the euro and the Japanese yen. In respect of other foreign currencies the statement is submitted where the transactions in the currency concerned exceed 5% of total foreign exchange turnover. Under Part B, banks submit the SSL for every foreign country in which they operate. In addition, banks are also required to report figures in respect of subsidiaries/joint ventures on a standalone basis. They are also required to report the maturity profile of any structured vehicles sponsored by them.

Under each of the above SSLs, banks are required to slot their assets and liabilities, including off-balance sheet items, into 10 time buckets showing outflows and inflows. These time buckets are (i) one day, (ii) two to seven days, (iii) eight to 14 days, (iv) 15 to 28 days, (v) 29 days up to three months, (vi) over three months and up to six months, (vii) over six months and up to one year, (viii) over one year and up to three years, (ix) over three years and up to five years, and (x) over five years.

Apart from calculating total outflows and inflows with respect to each of the time buckets, banks are also required to calculate cumulative outflows, mismatches (ie excess of inflows over outflows), mismatches as a percentage of outflows, and cumulative mismatches as a percentage of cumulative outflows. Further, the RBI has prescribed tolerance limits of 5%, 10%, 15% and 20% of the cumulative cash outflows in respect of buckets for next day, two to seven days, eight to 14 days, and 15 to 28 days for net cumulative negative mismatches for both the domestic and overseas operations (country-wise) structural liquidity statements.

In addition to the SSL, banks are also required to prepare and report a "Statement of short-term dynamic liquidity" to depict their short-term mismatches in four time buckets, namely next day, two to seven days, eight to 14 days, 15 to 28 days, and 29 to 90 days. This statement is also reported for both domestic and overseas operations.

II. Concentration of funding

The Basel standard tool is meant to identify sources of wholesale funding that are of such significance that their withdrawal could trigger liquidity problems. This metric thus encourages the diversification of funding sources. The RBI's instructions in this regard take into account the BCBS Rules Text and require banks to submit a monthly "Statement of funding concentration". This statement comprises two parts, namely (i) funding concentration based on counterparty and (ii) funding concentration based on instrument/product. The "Funding concentration based on counterparty" element is further subdivided into sections for "Significant counterparty – deposits and borrowings"; "Top 20 large deposits"; and "Top 10 borrowings". "Funding concentration based on instrument/product" is also sub-divided into "Significant instrument/product" and "Details of funding sources through securitisation". For the purpose of this statement, a "significant counterparty" is defined as a single counterparty or group of connected or affiliated counterparties accounting in aggregate for more than 1% of the bank's total liabilities. A "significant instrument/product" is defined as a single instrument/product of group of similar instruments/products which in aggregate amount to more than 1% of the bank's total liabilities.

Banks are required to furnish this statement separately for domestic and overseas operations. In the case of overseas operations, reporting is done according to jurisdiction.

III. Available unencumbered assets

This Basel monitoring tool is designed to provide supervisors with data on the quantity and key characteristics, including currency denomination and location, of banks' available unencumbered assets that could potentially be used as collateral to raise additional HQLA.

The RBI guidelines require banks to prepare and submit a quarterly "Statement of available unencumbered assets", with data on "Available unencumbered assets that are marketable as collateral in secondary markets and/or eligible for central bank's standing facilities". Banks are also required to provide such information for their significant currencies. Furthermore, for each such asset, banks must report the value, type of asset, location, estimated haircut required by the secondary market and expected monetised value of the collateral.

IV. LCR by significant currency

While the LCR is required to be met in one single currency, the Basel liquidity standard states that banks and supervisors should also monitor the LCR in significant currencies. This will allow the bank and the supervisor to track potential currency mismatch issues.

RBI guidelines require banks to submit a monthly "Statement on liquidity coverage ratio by significant currency". In line with the Basel standard, a currency is considered as "significant" if the aggregate liabilities denominated in that currency amount to 5% or more of the bank's total liabilities. Further, this statement should include only those assets and liabilities, including contingent liabilities that are denominated in the specific significant foreign currency. For the purpose of preparing this ratio, the types of HQLA, haircuts, adjustments, cash outflow and inflow items and their run-off rates are the same as in the case of the LCR in INR. As the foreign currency LCR is not a standard but a monitoring tool, the Basel Committee has not set any internationally defined minimum for this measure. Nonetheless, it has given discretion to the supervisors in each jurisdiction to set minimum monitoring ratios for the foreign exchange LCR, below which they should be alerted. Exercising this discretion, the RBI has not prescribed any minimum requirement at this juncture. However, the RBI may in future review this requirement in the light of experience gained.

V. Market-related monitoring tools

The purpose of these tools is to use high-frequency market data with little or no time lag as early warning indicators for potential liquidity difficulties at banks. While many types of data are available in the market, Basel standards broadly indicate that the supervisors can monitor data at certain given levels to focus on potential liquidity difficulties. These levels are (i) market-wide information; (ii) information on the financial sector; and (iii) bank-specific information.

The RBI's guidelines, in this regard, require banks to prepare and submit a monthly statement on "Other information" on liquidity. This statement comprises Part I – "Movement in prices of equity, non-equity, debt and money market instruments issued by the bank" and Part II – "Information on breach/penalty in respect of regulatory liquidity requirements". In the case of information on equity prices, banks are required to furnish information on equities issued by all the listed entities of the group. Such information relates to face value, opening price on the first trading day, highest price of the month and date, lowest price of the month and date, closing price on the last trading day and volatility (standard deviation) of the price of the shares of the listed entities of the banking group for the month. Banks are also required to report on "Letters of displeasure/strictures", if any, that were issued by the RBI and/or other regulators/ supervisors abroad on account of liquidity issues, or which could pose liquidity problems for the bank.

Annex 10: India's implementation of the *Principles of sound liquidity risk management and supervision*

This annex provides a qualitative description of the RBI's implementation of the Basel Committee's *Principles for sound liquidity risk management and supervision* (Sound Principles) in its regulation. The principles are not part of the formal RCAP assessment and no grade is assigned. This annex serves for information purposes only.

To implement the Sound Principles, the RBI issued comprehensive guidelines on "Liquidity risk management by banks" on 7 November 2012. While the complete BCBS Sound Principles are published as an appendix to these guidelines, the broad principles for sound liquidity risk management to be adopted by banks (Principles 1–12) are stated in the main body of the guidelines. As the principles on the role of supervisors (Principles 14–17) are for the supervisory authorities, the same are not included in the guidelines for the banks. These principles are already embedded in the RBI's existing supervisory and regulatory functions.

The RBI's guidelines on "Liquidity risk management by banks" contain its instructions on liquidity risk management, asset-liability management and the implementation of the Sound Principles. These are applicable to all scheduled commercial banks. Implementation of the Sound Principles in India by these guidelines is summarised in the following paragraphs:

Principle 1 – Fundamental principle for the management and supervision of liquidity risk

The instructions given by the RBI under this principle are:

(i) A bank should establish a robust liquidity risk management framework.

(ii) The Board of Directors (BoD) of a bank should be responsible for sound management of liquidity risk and should clearly articulate a liquidity risk tolerance appropriate for its business strategy and its role in the financial system.

(iii) The BoD should develop strategy, policies and practices to manage liquidity risk in accordance with the risk tolerance and ensure that the bank maintains sufficient liquidity. The BoD should review the strategy, policies and practices at least annually. A bank should have a sound process for identifying, measuring, monitoring and controlling liquidity risk, including a robust framework for comprehensively projecting cash flows arising from assets, liabilities and off-balance sheet items over an appropriate time horizon.

(iv) A bank's liquidity management process should be sufficient to meet its funding needs and cover both expected and unexpected deviations from normal operations.

(v) A bank should incorporate liquidity costs, benefits and risks in internal pricing, performance measurement and new product approval process for all significant business activities.

(vi) A bank should actively monitor and manage liquidity risk exposure and funding needs within and across legal entities, business lines and currencies, taking into account legal, regulatory and operational limitations to transferability of liquidity.

(vii) A bank should establish a funding strategy that provides effective diversification in the source and tenor of funding, and maintain ongoing presence in its chosen funding markets and counterparties, and address inhibiting factors in this regard.

(viii) Senior management should ensure that market access is being actively managed, monitored and tested by the appropriate staff.

(ix) A bank should identify alternate sources of funding that strengthen its capacity to withstand a variety of severe bank specific and market-wide liquidity shocks.

(x) A bank should actively manage its intraday liquidity positions and risks.

(xi) A bank should actively manage its collateral positions.

(xii) A bank should conduct stress tests on a regular basis for short-term and protracted institution-specific and market-wide stress scenarios and use stress test outcomes to adjust its liquidity risk management strategies, policies and position and develop effective contingency plans.

(xiii) Senior management of banks should monitor for potential liquidity stress events by using early warning indicators and event triggers. Early warning signals may include, but are not limited to, negative publicity concerning an asset class owned by the bank, increased potential for deterioration in the bank's financial condition, widening debt or credit default swap spreads, and increased concerns over the funding of off- balance sheet items.

(xiv) To mitigate the potential for reputational contagion, a bank should have a system of effective communication with counterparties, credit rating agencies and other stakeholders when liquidity problems arise.

(xv) A bank should have a formal contingency funding plan (CFP) that clearly sets out the strategies for addressing liquidity shortfalls in emergency situations. A CFP should delineate policies to manage a range of stress environments, establish clear lines of responsibility, and articulate clear implementation and escalation procedures.

(xvi) A bank should maintain a cushion of unencumbered, high-quality liquid assets to be held as insurance against a range of liquidity stress scenarios.

Principles 2 to 4 – Governance of liquidity risk management

The instructions given by the RBI under this principle are summarised below:

The RBI's guidelines on asset liability management (ALM), issued in February 1999 and October 2007, cover the liquidity risk management system of banks. The successful implementation of any risk management process has to emanate from the bank's top management with the demonstration of its strong commitment to integrating basic operations and strategic decision-making with risk management. Ideally, the organisational setup for liquidity risk management should comprise:

- The board of directors (BoD)
- The risk management committee
- The asset-liability management committee (ALCO)
- The asset-liability management (ALM) support group

The Liquidity Risk Management guidelines further elaborate the responsibilities, functions and composition of the above components of the organisational setup. These guidelines also contain broad instructions on liquidity risk management policy, strategies and practices, liquidity risk tolerance and strategy for managing liquidity risk. These guidelines can be accessed at http://rbi.org.in/scripts/NotificationUser.aspx?Id=7680&Mode=0.

Principles 5 to 12 – Measurement and management of liquidity risk

The instructions given by the RBI under this principle are summarised below:

The Liquidity Risk Management guidelines prescribe that a bank should have a sound process for identifying, measuring, monitoring and mitigating liquidity risk. Liquidity can be measured through stock and flow approaches.

Flow approach measurement involves comprehensive tracking of cash flow mismatches. For measuring and managing cash flow mismatches in different time bands, RBI requires banks to submit the "Statement of structural liquidity", details of which are given in Annex 9 to this report. The net cumulative negative mismatches in the domestic and overseas structural liquidity statement during the time buckets for the (i) next day, (ii) two to seven days, (iii) eight to 14 days, (iv) 15 to 28 days should not exceed 5%, 10%, 15%, and 20% of the cumulative cash outflows in the respective time buckets. In respect of mismatches in cash flows in the near-term buckets, up to 28 days, the bank's management should aim to keep cash flow mismatches at minimum levels. To enable banks to monitor their short-term liquidity on a dynamic basis over a time horizon spanning from one to 90 days, banks are required to estimate their short-term liquidity profiles on the basis of business projections and other commitments for planning purposes and prepare a "Statement of short-term dynamic liquidity".

Under the stock approach, the RBI has prescribed certain critical ratios in respect of liquidity risk management. Banks are required to monitor these ratios by putting in place an internally defined limit approved by the board for these ratios. The stock ratios are used to monitor liquidity risk at the solo bank level. Banks are also required to apply these ratios to monitor liquidity risk in US dollars, pounds sterling, euros and Japanese yen at the solo bank level. These ratios are (i) (volatile liabilities – temporary assets)/(earning assets – temporary assets) (ii) core deposits/total assets (iii) (loans + mandatory SLR + mandatory CRR + fixed assets)/total assets (iv) (loans + mandatory SLR + mandatory CRR + fixed assets)/core deposits (v) temporary assets/total assets (vi) temporary assets/volatile liabilities (vii) volatile liabilities/total assets.

The Liquidity Risk Management guidelines also reiterate the RBI's prudential limits on inter-bank liability and call money borrowing and lending by banks. In addition, detailed instructions on off-balance sheet exposures and contingent liabilities, collateral position management, intraday liquidity position management, incorporation of liquidity costs, benefits and risks in the internal pricing, funding strategy – diversified funding, liquidity risk due to intragroup transfers, stress testing and contingency funding plan are also contained in these guidelines. The guidelines also elaborate the requirements for the liquidity risk management of overseas operations of Indian banks' branches and subsidiaries.

Furthermore, the RBI has also issued separate guidelines on "Monitoring tools for intraday liquidity management" via the circular of 3 November 2014, by which banks are required to manage and monitor their intraday liquidity and submit a monthly return to the RBI.

Principle 13 – Public disclosure

The Liquidity Risk Management guidelines require that a bank should regularly disclose its liquidity information so that market participants can make an informed judgment about the soundness of its liquidity risk management framework and liquidity position.

A bank's liquidity policy and procedures should provide detailed procedures and guidelines for the management of operational liquidity at its overseas branches or subsidiaries.

Principles 14 to 17 – The role of supervisors

The RBI’s supervisory role in ensuring the sound liquidity of banks and adherence to the regulatory instructions on liquidity risk management is comprehensive and includes both on-site inspection and off-site supervision through regulatory returns. On-site inspections include detailed examination of a bank’s liquidity risk management framework, organisation and the workings of its liquidity risk management functions, minutes of the various ALCO meetings, integrity of data input for preparing various supervisory returns, actual involvement of management in liquidity risk management, contingency funding plans and their adequacy etc. In addition, liquidity risk forms an important component of the RBI’s supervisory ratings of banks. Under the off-site surveillance regime, banks submit various liquidity returns to RBI. These are periodically examined to assess banks’ liquidity condition. Currently, some of the large banks have been brought under the RBI’s Risk-Based Supervision Framework and regular prudential meetings with such banks take place. In addition, the RBI also holds a quarterly informal discussion with the banks.

Based on information collected from banks, the RBI also performs supervisory stress tests to assess their resilience to liquidity stress. The results of such tests and their interpretation are also published in the RBI’s half-yearly Financial Stability Report.

In the event that the RBI identifies concerns or deficiencies in a bank’s liquidity position or liquidity risk management process, the RBI has a range of supervisory tools or responses to address those concerns or deficiencies, taking account of the level of risk which the concern or deficiency poses to the safety and soundness of the bank concerned or to the wider financial system.

The RBI also maintains regular communication with relevant supervisory authorities (eg those of the securities and insurance sectors) in India and other central banks, banking supervisors, and payment and settlement overseers outside India. In many instances, memoranda of understanding have been signed with the relevant authority, which set out the protocol, procedures and channels for exchanges of information on issues of mutual supervisory concern, including crisis situations, and supervisory cooperation to resolve such issues. The RBI also actively participates in various supervisory colleges for internationally active banks. These arrangements support and facilitate the RBI’s supervision of banks’ liquidity risk and related risk management.

Annex 11: Areas for further guidance from the Basel Committee

Treatment of state government exposures in the LCR

In the context of this RCAP exercise, the Assessment Team takes the position that it does not view state government exposures as being "sovereign" for the purpose of the LCR. To clear all doubt on this matter, the Assessment Team requests that the Basel Committee confirms this interpretation, at the conceptual level, of whether state exposures can be regarded as "sovereign" in the context of the HQLA calculation.

Annex 12: List of issues for follow-up RCAP assessments

The Assessment Team identified the interaction between the new LCR requirements and the existing liquidity requirements in India – the Statutory Liquidity Ratio (SLR) – for follow-up and review in a future RCAP assessment.

Annex 13: Areas where Indian LCR rules are stricter than the Basel standards

In several places, the Indian authorities have adopted a stricter approach than the minimum standards prescribed by Basel or have simplified or generalised an approach in a way that does not necessarily result in stricter requirements under all circumstances but never results in less rigorous requirements than the Basel standards. The following list provides an overview of these areas. It should be noted that these areas have not been taken into account as mitigants for the overall assessment of compliance.

Definition of HQLA

Basel paragraph 52(b)

While the Basel standard allows corporate debt securities (including commercial paper) as well as covered bonds that satisfy certain conditions as Level 2A assets, the RBI does not allow covered bonds as Level 2A assets in this category

Basel paragraph 54(a) and (b)

While the Basel standard allows residential mortgage-backed securities and corporate debt securities (including commercial paper) that satisfy certain conditions as Level 2B assets, the RBI does not allow these as Level 2B assets.

Scope of application

Basel paragraph 164

While the Basel standard prescribes mandatory application of LCR and monitoring tools on internationally active banks, RBI guidelines prescribe these to be mandatorily applicable to all scheduled commercial banks.

Annex 14: Implementation of LCR elements subject to prudential judgment or discretion in India

The following tables provide information on elements of LCR implementation that are subject to prudential judgment and national discretion. The information provided helps the Basel Committee to identify implementation issues where clarifications and (additional) FAQs could improve the quality and consistency of implementation. It should also inform the preliminary design of any peer comparison of consistency across the membership that the Committee may decide to conduct, in similar fashion to the studies on risk-weighted asset variation for the capital standards.

Elements requiring judgment (non-comprehensive list) Table 6

Basel paragraph	Description	Implementation by the Indian authorities
24(f)	Treatment of the concept of "large, deep and active markets".	The term "large, deep and active markets" is used in paras 38, 50(c), 52(a) and (b), and 54(a) to (c) of the BCBS LCR document as a general description of the characteristics of markets in which assets that can be recognised as HQLA should be traded. Similarly, RBI's guidelines on LCR also refer to this term as a characteristic for HQLAs. In addition, RBI has also defined "active and sizeable market" under "market-related characteristics" as "*Assets included in the stock of HQLAs should have active outright sale or repo markets at all times. This can be ensured by presence of historical evidence of market breadth and market depth, eg low bid-ask spreads, high trading volumes, and a large and diverse number of market participants.* *Further, there should be robust market infrastructure as also multiple committed market-makers for the asset.*"
50	Treatment of the concept of "reliable source of liquidity".	The RBI has adopted this concept as an essential characteristic for all HQLAs, ie Levels 1, 2A and 2B. It is assumed that, if an asset is regularly traded in a large, deep and active market, it will be a reliable source of liquidity. Going forward, RBI may use this concept for including or excluding a specific asset from the list of HQLAs based on the market behaviour as a source of liquidity in respect of that asset in times of financial stress.
52	Treatment of the concept of "relevant period of significant liquidity stress".	The BCBS LCR standard has used the term "relevant period of significant liquidity stress" for determining the characteristic "reliable source of liquidity" of Level 2A and Level 2B assets. The qualifying assets under HQLAs should not decline in price, and a haircut should not increase by more than the prescribed percentage over a 30-day period during a relevant period of significant liquidity. RBI has used the same concept while prescribing the essential characteristic of HQLAs. As regards what constitutes a "relevant period of significant liquidity stress", the RBI considers that such liquidity stress should be significant enough to disrupt the liquidity conditions and/or effective

		operation of financial markets in the jurisdiction(s) affected by the stress or crisis. Historical examples of such stress events include the 1997 Asian financial crisis and the 2007–08 global financial crisis.
74–84	Retail deposits are divided into "stable" and "less stable".	The RBI has subdivided retail deposits into "stable" and "less stable", based on the criteria prescribed by the BCBS Rules text. These definitions are appended below: (ii) Stable deposits: these are insured deposits (to the extent covered by Deposit Insurance and Credit Guarantee Corporation (DICGC) in transactional accounts where salaries/pensions are automatically deposited or are paid out from relationship-based accounts (eg the deposit customer has another relationship with the bank, say, a loan). (iii) Less stable deposits: other than stable deposits.
83, 86	Treatment of the possibility of early withdrawal of funding with maturity above 30 days (para 83 – retail deposits; para 86 – wholesale funding).	Retail deposits: All demand and term deposits (irrespective of maturity) including foreign currency deposits placed with a bank by a natural person are required to be classified as retail deposits with run-off rates of 5% for "stable deposits" and 10% for "less stable deposits". However, in cases of bulk deposits ie INR 1 crore and above where banks have decided to disallow premature withdrawal in terms of circular DBOD.No.Dir.BC.74/13.03.00/2012-13 dated 24 January 2013 on "Interest rates on and premature withdrawal of rupee term deposits", bulk deposits of residual maturity of more than 30 days may be excluded from outflows. Cash outflows related to retail term deposits with a residual maturity or withdrawal notice period of greater than 30 days can be excluded from total expected cash outflows if the depositor has no legal right to withdraw deposits within the 30-day horizon of the LCR, or if early withdrawal results in a significant penalty that is materially greater than the loss of interest. Despite a clause that says the depositor has no legal right to withdraw a deposit, if a bank allows a depositor to withdraw such deposits or waives the applicable penalty for the premature withdrawal, the entire category of these funds would then have to be treated as demand deposits (ie regardless of the remaining term, the deposits would be subject to run-off rates applicable to retail deposits). Unsecured wholesale funding: The unsecured wholesale funding included in the LCR is defined as all funding from non-natural persons (ie legal entities including sole proprietor or partnership), and are not collateralised by legal rights to specifically designated assets owned by the borrowing institution. This funding is callable within the LCR's horizon of 30 days or has its earliest possible contractual maturity date situated within this horizon (such as maturing term deposits and unsecured debt securities) as is also funding with an undetermined maturity.
90–91	Definition of small business customers' exposure is based on nominal EUR amount (1	RBI has defined the small business customer as below: Small business customers: this category consists of

	million).	deposits and other extensions of funds made by non-financial small business customers, as defined in para 5.9.3(i) of the RBI's Master Circular on Basel III Capital Regulations dated 1 July 2013, that are managed as retail exposures and are generally considered as having similar liquidity risk characteristics to retail accounts provided total aggregated funding from any such small business customer is up to INR 5 crore (on a consolidated basis where applicable). "Aggregated funding" means the gross amount (ie not netting any form of credit extended to the legal entity) of all forms of funding (eg deposits or debt securities or similar derivative exposure for which the counterparty is known to be a small business customer).
94–103	Deposits subject to "operational" relationships.	The RBI has prescribed detailed instructions on "Operational deposits" on the lines of the Basel Standards. Operational deposits: Qualifying operational deposits are the deposits generated by clearing, custody or cash management activities where financial and non-financial customers are required to maintain deposits with a bank in order to facilitate their access and ability to use payment and settlement systems or make payments. If such deposits qualify under certain criteria, they can attract relatively lower run-off rates (25% if uninsured and 5% if insured under deposit insurance). Definition, qualifying criteria and other conditions for this purpose are given below: (a) Definitions and criteria for qualifying activities which can generate operational deposits • Clearing relationship: A service arrangement that enables customers to transfer funds (or securities) indirectly through direct participants in domestic settlement systems to final recipients. Such services are limited to the following activities: transmission, reconciliation and confirmation of payment orders; daylight overdraft, overnight financing and maintenance of post-settlement balances; and determination of intraday and final settlement positions. • Custody relationship: the provision of safekeeping, reporting, processing of assets or the facilitation of the operational and administrative elements of related activities on behalf of customers in the process of their transacting and retaining financial assets. Such services are limited to the settlement of securities transactions, the transfer of contractual payments, the processing of collateral, and the provision of custody-related cash management services. Also included are the receipt of dividends and other income, client subscriptions and redemptions. Custodial services can extend to asset and corporate trust servicing, treasury, escrow, funds transfer, stock transfer and agency services, including payment and settlement services (excluding correspondent banking), and depositary receipts. • Cash management relationship: the provision of cash management and related services to

		customers. Cash management services, in this context, refers to products and services provided to a customer to manage its cash flows, assets and liabilities, and conduct financial transactions necessary to the customer's ongoing operations. Such services are limited to payment remittance, collection and aggregation of funds, payroll administration, and control over the disbursement of funds. • The customer should have substantial dependency on the bank to perform the above services as an independent third party intermediary in order to fulfil its normal banking activities over the next 30 days and the deposits are required for the above purposes. • Eligibility for 25% run-off rate for operational deposits generated by the above activities would require approval from the RBI's Department of Banking Supervision so as to ensure that these operational activities are actually being conducted by the banks. • The above services must be provided under a legally binding agreement to institutional customers. The termination of such agreements shall be subject either to a notice period of at least 30 days or significant switching costs (such as those related to transaction, information technology, early termination or legal costs) to be borne by the customer if the operational deposits are withdrawn before 30 days. (b) Qualifying criteria and other conditions • The deposits are by-products of the underlying services provided by the banking organisation and not sought out in the wholesale market in the sole interest of offering interest income. • The deposits are held in specifically designated accounts and priced without giving an economic incentive to the customer (not limited to paying market interest rates) to leave any excess funds on these accounts. In the case that interest rates in a jurisdiction are close to zero, it would be expected that such accounts are non-interest bearing. Banks should be particularly aware that during prolonged periods of low interest rates, excess balances (as defined below) could be significant. • Any excess balances that could be withdrawn and would still leave enough funds to fulfil these clearing, custody and cash management activities will not qualify for the 25% run-off factor. In other words, only that part of the deposit balance with the service provider that is proven to serve a customer's operational needs can qualify as stable. Excess balances should be treated in the appropriate category for non-operational deposits. If banks are unable to determine the amount of the excess balance, then the entire deposit should be assumed to be excess to requirements and, therefore, considered non-

		operational. • Operational deposits held by banks at other financial institutions for operational purposes are assumed to stay at those institutions, and no inflows can be counted for these funds – ie they will receive a 0% inflow rate.
131(f)	Definition of other financial institutions and other legal entities.	The contents of the paragraph as a general reference to other financial institutions and other legal entities appear similarly in RBI guidelines.

Elements left to national discretion (non-comprehensive list)

Table 7

Basel paragraph	Description	Implementation by the Indian authorities
5	These two standards [the LCR and NSFR] comprise mainly specific parameters that are internationally "harmonised" with prescribed values. Certain parameters, however, contain elements of national discretion to reflect jurisdiction-specific conditions. In these cases, the parameters should be transparent and clearly outlined in the regulations of each jurisdiction to provide clarity both within the jurisdiction and internationally.	Regarding the LCR, the RBI has taken the discretion to prescribe outflow rates for "stable" and "less stable" deposits and trade finance instruments.
8	Use of phase-in options.	The RBI has mandated the phase-in transitional arrangement proposed by Basel Committee to implement the LCR in India starting from 1 January 2015, with a 60% minimum requirement set for the year 2015, followed by increments of 10 percentage points per annum until reaching 100% by 1 January 2019.
11	The Committee also reaffirms its view that, during periods of stress, it would be entirely appropriate for banks to use their stock of HQLA, thereby falling below the minimum. Supervisors will subsequently assess this situation and will give guidance on usability according to circumstances. Furthermore, individual countries that are receiving financial support for macroeconomic and structural reform purposes may choose a different implementation schedule for their national banking systems, consistent with the design of their broader economic restructuring programme.	During a period of financial stress, banks have been allowed by RBI to use their stock of HQLA, thereby falling below the minimum required LCR. However, banks should immediately report to RBI such use of their stock of HQLA along with reasons for such usage and the corrective steps initiated to rectify the situation.
50(b)	Eligibility of central bank reserves.	Excess reserves allowed as Level 1 HQLA.
50(c)	Marketable securities that are assigned a 0% risk weight under the Basel II Standardised Approach for credit risk.	RBI has fully implemented this on the lines of the Basel Standard as contained in para 50(c), (d) and (e).
53–54	Eligible Level 2B assets.	RBI has allowed the following as Level 2B HQLAs: (i) Marketable securities representing claims on or claims guaranteed by sovereigns having risk weights

		higher than 20% but not higher than 50%, ie they should have a credit rating not lower than BBB– as per the RBI's Master Circular on Basel III – Capital Regulations. Apart from the usual fundamental and market-related characteristics as given in Appendix III, these securities should also have a proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions, ie a maximum price decline not exceeding 20% or an increase in haircut over a 30-day period not exceeding 20 percentage points during a relevant period of significant liquidity stress. (ii) Common equity shares which satisfy all of the following conditions: (a) not issued by a bank/financial institution/NBFC or any of its affiliated entities; (b) included in NSE CNX Nifty index and/or S&P BSE Sensex index; (c) in addition to the usual fundamental and market-related characteristics set out in Appendix III, these securities should also have a proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions, ie a maximum decline of share price not exceeding 40% or an increase in haircut over a 30-day period not exceeding 40 percentage points during a relevant period of significant liquidity stress.
54a	Provision relating to the use of restricted contractual committed liquidity facilities (RCLF).[7]	Not applicable.
55(f)	Treatment for jurisdictions with insufficient HQLA (subject to separate peer review process).	Not applicable.
68	Treatment of shariah-compliant banks.	Not applicable.
78	Treatment of deposit insurance.	This has been implemented for defining "stable retail deposits" on the lines of the BCBS standard.
79(f)	Categories and run-off rates for less stable deposits.	The RBI has implemented this for "retail deposits" and "Demand and term deposits (less than 30 days maturity) provided by small business customers". The run-off rate prescribed under both the categories is 10%.
123	Market valuation changes on derivative transactions.	This has been fully implemented on the lines of the Basel Rules Text.
134–140	Run-off rates for other contingent funding liabilities.	The RBI has prescribed a run-off rate of 5% for all items under this category.
160	Weight assigned to other contractual inflows.	The RBI has prescribed a weight of 50% for this category.

[7] See www.bis.org/publ/bcbs274.htm.

164–165	Determination of scope of application of LCR (whether to apply beyond "internationally active banks" etc) and scope of consolidation of entities within a banking group.	Implemented. Applicable to all scheduled commercial banks in India. This will be mandatorily applicable from 1 January 2016 for reporting the LCR on a consolidated basis.
168–170	Differences in home/host liquidity requirements due to national discretions.	The relevant instructions are appended below: When calculating the LCR on a consolidated basis, a cross-border banking group should apply the liquidity parameters adopted in the home jurisdiction to all legal entities being consolidated except for the treatment of retail/small business deposits that should follow the relevant parameters adopted in host jurisdictions in which the entities (branch or subsidiary) operate. This approach will enable the stressed liquidity needs of the group's legal entities (including branches of those entities) operating in host jurisdictions to be more suitably reflected, given that deposit run-off rates in host jurisdictions are more influenced by jurisdiction-specific factors such as the type and effectiveness of deposit insurance schemes in place and the behaviour of local depositors. Home requirements for retail and small business deposits should apply to the relevant legal entities (including branches of those entities) operating in host jurisdictions if: (i) there are no host requirements for retail and small business deposits in the particular jurisdictions; (ii) those entities operate in host jurisdictions that have not implemented the LCR; or (iii) the home supervisor decides that home requirements should be used that are stricter than the host requirements.
Annex 2	Principles for assessing eligibility for alternative liquidity approaches (ALA).	Not applicable.