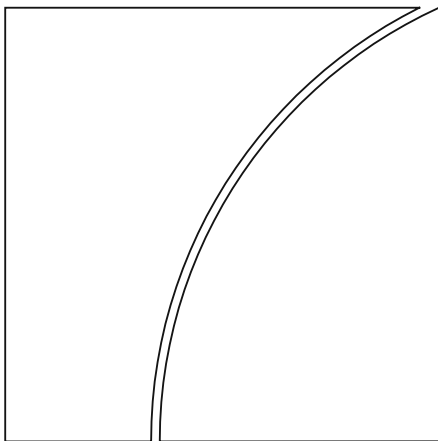


# Basel Committee on Banking Supervision



## Regulatory Consistency Assessment Programme (RCAP)

### Assessment of Basel NSFR regulations – India

July 2019



BANK FOR INTERNATIONAL SETTLEMENTS

**Note that this report refers to the RCAP grades prior to October 2025. The grade 'materially non-compliant (MNC)', ie one notch above the lowest grade, has since been renamed to 'partially non-compliant (PNC)' for greater clarity**

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## Glossary

|        |  |
|--------|--|
| ASF    | Available stable funding                                 |
| BC     | Bank Circular  |
| BIS    | Bank for International Settlements                       |
| BP     | Banking Policy   |
| C      | Compliant (grade)  |
| DBR    | Department of Banking Regulation                         |
| FALLCR | Facility to avail liquidity for Liquidity Coverage Ratio |
| FAQ    | Frequently asked question                                |
| G-SIB  | Global systemically important bank                       |
| HDFC   | Housing Development Finance Corporation                  |
| HQLA   | High-quality liquid assets                               |
| ICICI  | Industrial Credit and Investment Corporation of India    |
| LC     | Largely compliant (grade)                                |
| LCR    | Liquidity Coverage Ratio                                 |
| MNC    | Materially non-compliant (grade)                         |
| MSF    | Marginal standing facility                               |
| NC     | Non-compliant (grade)                                    |
| NDTL   | Net demand and time liabilities                          |
| NSFR   | Net Stable Funding Ratio                                 |
| RBI    | Reserve Bank of India                                    |
| RCAP   | Regulatory Consistency Assessment Programme              |
| RSF    | Required stable funding                                  |
| SDL    | State Development Loan                                   |
| SIG    | Supervision and Implementation Group                     |
| SLR    | Statutory Liquidity Ratio                                |

## Preface

The Basel Committee on Banking Supervision (Basel Committee) places 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 fully, consistently and in a timely manner by all member jurisdictions. The Committee established the Regulatory Consistency Assessment Programme (RCAP) to monitor, assess and evaluate its members' implementation of the Basel framework.

This report presents the findings of an RCAP Assessment Team on the domestic adoption of the Basel Net Stable Funding Ratio (NSFR) standard in India. The assessment focused on the completeness and consistency of the domestic regulations in force on 31 December 2018, as applied to commercial banks in India, with the Basel NSFR standard. Issues related to prudential outcomes, the adequacy of liquidity, the resilience of the banking system or the supervisory effectiveness of the Indian authorities were not in the scope of this assessment. The assessment relied on regulations, other information and explanations provided by the Indian authorities, and it ultimately reflects the view of the Basel Committee.

The RCAP Assessment Team was led by Vasily Pozdyshev, Deputy Governor of the Central Bank of the Russian Federation. It comprised four technical experts, from Belgium, Brazil, Denmark and the Basel Committee Secretariat (see Annex 1). The main counterpart for the assessment was the Reserve Bank of India (RBI). The work was coordinated by the Basel Committee Secretariat with support from staff from the Central Bank of the Russian Federation.

The assessment began in early 2018 and comprised (i) a self-assessment by the assessed jurisdiction's authorities; (ii) an assessment phase (June to December 2018), including an on-site assessment involving discussions with the Indian authorities, banks and rating agencies; and (iii) a review phase (January to February 2019), including a technical review of the Assessment Team's findings by a separate RCAP Review Team, the Committee's Supervision and Implementation Group, the RCAP Peer Review Board and the Basel Committee. More information on the RCAP assessment process is available on the Committee's website.<sup>1</sup>

The Assessment Team acknowledges the professional cooperation received from the RBI throughout the assessment process. In particular, the team sincerely thanks the staff of the RBI for coordinating the exercise and the series of comprehensive briefings and clarifications received, as well as the representatives of Indian banks and rating agencies that provided information. The Assessment Team is hopeful that the RCAP assessment will contribute to the sound initiatives already undertaken by the Indian authorities and to further strengthening the prudential effectiveness of liquidity regulation in India.

<sup>1</sup> See [www.bis.org/bcbs/implementation.htm](http://www.bis.org/bcbs/implementation.htm).

## Executive summary

In India, the NSFR requirements were implemented by way of a circular issued in May 2018, with the effective date of 1 April 2020 confirmed by a subsequent circular issued in November 2018. Despite this delay from the Basel Committee's agreed implementation date of 1 January 2018, the NSFR regulations in India are assessed as compliant with the Basel NSFR standards. This is the higher overall grade.

Three of the four components of the Basel NSFR standard (scope, minimum requirements and application issues; available stable funding; and disclosure requirements) are assessed as compliant. The remaining component, required stable funding (RSF), is assessed as largely compliant. This is due to the inclusion of securities issued by state governments as Level 1 high-quality liquid assets (HQLA), which, under the NSFR standard, attract an RSF factor of 5%. Following the finding of a previous RCAP assessment of the Indian implementation of the Liquidity Coverage Ratio (LCR), the Assessment Team considered the effect on banks' NSFRs of applying the higher RSF factors assigned to Level 2 HQLA. Such adjustments have a material effect on Indian banks' NSFRs. A different definition of "past due" for certain types of agricultural loan also has a material effect on the sample banks' NSFR.

The Assessment Team also reviewed the interaction of the Indian Statutory Liquidity Ratio (SLR) with the LCR and the NSFR as recommended in the RCAP-LCR assessment. This ratio has been used in prudential regulation in India for many years and has a similar objective to the LCR. The Assessment Team concludes that, in practice, the SLR does not encumber assets that would be used for the NSFR requirement because of the RBI's active monitoring and ability to change the SLR as needed. The Assessment Team recommends a review of this issue in the next RCAP assessment.

## Response from the Reserve Bank of India

The Reserve Bank of India (RBI) appreciates the thorough and professional assessment of the NSFR guidelines, as issued to Indian Banks, by the RCAP Assessment Team led by Mr Vasily Pozdyshev, Deputy Governor of the Central Bank of the Russian Federation. The exercise has been of immense help to the RBI as we have gained from useful insights provided by the team. The RBI welcomes the opportunity given to respond to the findings on the implementation of NSFR framework in India.

The RBI generally agrees with the findings of this assessment report. However, the team has flagged two material findings, the first relating to classification of State Development Loans (SDLs) and second, relating to the assignment of a higher RSF factor for agricultural crop loan NPAs, which has led to a largely compliant grading for required stable funding (RSF).

The first material finding relating to SDLs is a fall-out from the assessment of India's LCR regulations made in 2015 by an RCAP team. The RBI reiterates the response given at the time of the LCR assessment, that the Constitution of India provides strong law-making and revenue-raising power for States. In terms of sovereign backing, state government securities/SDLs are on par with the central government's debt. Further, SDLs meet the fundamental and market-related characteristics for HQLA as they are issued and traded in markets very similar to that for central government securities. SDLs are also eligible as collateral for borrowing through repo and borrowing from the RBI's Liquidity Adjustment Facility. It is pertinent to add that the RCAP assessment team on LCR had sought clarification from the BCBS as to whether the state exposures can be treated as sovereign in the context of the calculation of HQLAs. The BCBS has yet to confirm the stand taken by RCAP team. In the absence of a clarification, the RBI is of the view that SDLs qualify as Level 1 HQLAs. Pertinently, the NSFR of sample banks continues to be comfortably above 100%, even if the SDLs are considered as Level 2A HQLAs.

The second material finding relates to not treating agricultural crop loans as past due beyond 90 days as NPAs and thereby attracting a lower RSF factor. There are good reasons for this. In particular, the loans are not considered as past due, or classified as NPA after 90 days, because the repayment of the agricultural crop loan is linked to the harvesting season. In India, agriculture is heavily dependent on the adequacy and timeliness of rainfall. The main source of income of farmers is dependent on the sale of agricultural produce. Thus, unless they harvest and sell their produce, it would be difficult for them to repay the crop loans. The harvesting of crops is heavily dependent on rainfall patterns. Keeping these uncertainties in mind, the RBI has consciously not followed the 90-day convention, and instead linked repayment to crop seasons, for the purposes of classifying agricultural crop loans as NPA. As may be appreciated, the 90-day period for NPA classification is a prevalent practice but not a norm or a standard. Accordingly, we do not believe a higher RSF factor is warranted on agricultural crop loans.

We are thankful for the learnings and fresh perspectives we have gained from our interactions with the Assessment Team.



# 1 Assessment context

## 1.1 Status of NSFR implementation

The Reserve Bank of India (RBI) is the monetary and banking authority of India. As the banking authority, it is responsible for supervision and control of the banking sector under the Indian Banking Regulation Act. The RBI implemented the NSFR standard by way of Guidelines issued in May 2018 and a Circular on the effective date issued in November 2018.

The requirements will apply to all scheduled commercial banks, with the exception of regional rural banks, from April 2020.<sup>2</sup> This scope of application is consistent with the RBI's application of other Basel III requirements.

## 1.2 Regulatory system

The Indian Banking Regulation Act empowers the RBI to issue and amend banking regulations, as well as to issue banking licences and carry out supervisory inspections of any banking entity in India. The NSFR standard has been implemented in India by way of guidelines, which are considered binding for the purpose of this assessment. More information is provided in Annex 2.

## 1.3 Structure of the banking sector

The Indian banking sector comprises both public sector and private banks, with public sector banks playing a significant role. Scheduled commercial banks dominate the banking system, with the balance comprising small regional rural banks, rural cooperative banks and urban cooperative banks. Although these latter entities hold a relatively small share of banking system assets, they play a key role in providing access to banking services for low- and middle-income households.

The RBI applies Basel III requirements, including the NSFR (once effective), to all scheduled commercial banks. Of around 100 banks operating in India, around 90 are subject to these requirements. Scheduled commercial banks have a range of business models, including some universal banks.

In evaluating the materiality of its findings, the RCAP Assessment Team focused on 11 of the largest banks in India, which included those six that are internationally active. Together, these banks comprise about 64% of the banking sector and all of the assets of internationally active banks in India. Annex 3 provides further information on the banking system in India and the NSFR of the sample banks.

## 1.4 Scope of the assessment

The Assessment Team considered the NSFR requirements applicable to commercial banks in India as of 31 December 2018. The assessment had two dimensions:

- a comparison of domestic regulations with the Basel NSFR standard to ascertain that all the required provisions have been adopted (*completeness* of the regulations); and
- whether there are any differences in substance between the domestic regulations and the Basel NSFR standard and, if so, their significance (*consistency* of the regulations).

<sup>2</sup> A scheduled bank refers to a bank which is listed in the Second Schedule of the Reserve Bank of India Act, 1934. Banks not under this Schedule are called non-scheduled banks. Scheduled banks are usually private, foreign and nationalised banks operating in India.

In its assessment, the RCAP Assessment Team considered all binding documents that effectively implement the Basel NSFR standard in India. Annex 2 lists the Basel standards used as the basis for the assessment. The assessment did not evaluate the adequacy of liquidity or the resilience of the banking system in India or the supervisory effectiveness of the RBI.

As set out in the RCAP methodology, the Assessment Team evaluated the materiality and potential materiality of identified deviations between the Basel NSFR standard and the local regulations. The quantification was limited to a sample of banks. In addition, the Assessment Team reviewed the non-quantifiable aspects of identified deviations and applied expert judgment as to whether the domestic regulations meet the Basel framework in letter and in spirit. The materiality analysis is summarised in Annex 4, which also lists the sample of banks.

In several areas, the Basel NSFR standard refers to the Basel LCR standard. These regulations were reviewed by a separate RCAP-LCR assessment, published in 2015.<sup>3</sup> The RCAP-NSFR Assessment Team relied on the findings of the RCAP-LCR Assessment Team with respect to the compliance of the Indian regulations with the definitions used in both the LCR and the NSFR.

The outcome of the assessment is summarised using a four-grade scale, both at the level of each of the four key components of the Basel NSFR framework and the overall assessment of compliance. The four grades are compliant, largely compliant, materially non-compliant and non-compliant.

## 2 Assessment findings

### 2.1 Assessment grades and summary of findings

Overall, the Assessment Team finds the implementation of the NSFR in India to be compliant with the Basel standards.

Assessment grades

Table 1

| Component of the Basel NSFR framework             | Grade |
|---|-------|
| Overall grade                                     | C     |
| Scope, minimum requirement and application issues | C     |
| Available stable funding (numerator)              | C     |
| Required stable funding (denominator)             | LC    |
| NSFR disclosure requirements                      | C     |

Assessment scale: C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant).

#### 2.1.1 Scope, minimum requirement and application issues

This component is assessed as compliant with the Basel standard. No findings were identified.

The Assessment Team observes that the implementation date for the NSFR in India is April 2020, over two years after the Basel Committee's agreed implementation date of January 2018.

<sup>3</sup> *Regulatory Consistency Assessment Programme (RCAP) – Assessment of Basel III LCR regulations – India*, Basel Committee, June 2015, [www.bis.org/bcbs/publ/d321.htm](http://www.bis.org/bcbs/publ/d321.htm).

### 2.1.2 Available stable funding

This component is assessed as compliant with the Basel standard. No findings were identified.

### 2.1.3 Required stable funding

This component is assessed as largely compliant with the Basel standard. The Assessment Team identified two material findings with respect to the allocation of RSF factors to assets and off-balance-sheet exposures, which together contributed to the component grade.

First, following the RCAP-LCR finding that State Development Loans (SDLs) should not be treated as Level 1 HQLA (which attracts an RSF factor of 5%), the RCAP-NSFR Assessment Team estimated the effect of increasing the RSF to different factor levels. Based on implied market information from similarly situated assets, the Assessment Team believes that SDLs are more similar to Level 2A than to Level 2B HQLAs, the former attracting an RSF factor of 15% and the latter an RSF of 50%. This has a material effect on banks' NSFRs, with the Assessment Team considering an average effect of 1.5 percentage points to be a reasonable estimate across the sample banks.

Second, the Assessment Team noted a finding from the RCAP-Capital assessment of India with respect to the definition of past due for certain short-term agricultural loans. These loans are not considered past due after 90 days, but with respect to crop seasons, which vary between three months and one year. The Assessment Team considered that a higher RSF factor was warranted for such loans, as a share of these loans would be considered non-performing under the Basel past-due definition. The effect on banks' NSFR ratios would be material, at an upper bound of 0.72 percentage points on average across the sample banks and in excess of 2.5 percentage points at one of the sample banks.

### 2.1.4 Disclosure requirements

The Indian disclosure requirements for the NSFR are assessed as compliant with the Basel standards.

Aside from the delay in implementation, the only finding relates to the absence of requirements for banks to clearly "signpost" disclosures presented outside the annual report. This is deemed non-material.

## 2.2 Detailed assessment findings

### 2.2.1 Scope, minimum requirement and application issues

The component was judged to be compliant with the Basel framework. No findings were identified.

### 2.2.2 Available stable funding

The component was judged to be compliant with the Basel framework. No findings were identified.

### 2.2.3 Required stable funding

| Section grade                        | Largely compliant  |
|--------------------------------------|--|
| Basel paragraph number               | 16, 37: state government securities  |
| Reference in the domestic regulation | RBI NSFR Circular, paragraph 9.3   |
| Finding                              | <p>The Basel NSFR standard makes use of several definitions in the Basel LCR standard. Jurisdictions are expected to mirror these definitions, unless the jurisdiction chooses to adopt a stricter definition in a particular case. In particular, assets classified as Level 1 HQLA receive a RSF factor of 5%.</p> <p>The RCAP-LCR assessment of India notes that securities issued by state governments (State Development Loans, or SDLs) should not be classified as sovereigns for the</p> |

|                                      |   |
|--------------------------------------|---|
|                                      | <p>purpose of the definition of HQLA (ie under the application of paragraph 50(d) of the Basel LCR standard). As the Basel NSFR standard relies on the LCR Basel standard, the Assessment Team accepted the RCAP-LCR assessment finding and was thus required to consider the appropriate RSF according to the NSFR standard. The RCAP-LCR assessment found that SDLs are not Level 1 HQLA, but did not conclude on a different classification.</p> <p>SDLs are typically unrated and issued through auctions by the RBI. The RBI can also debit the account of the federal government in case a state does not meet its obligation when payments come due. Banks and other market participants regard the SDLs as highly liquid, but still perceive a difference between central government debt and SDLs, and among SDLs issued by different states in terms of spreads and liquidity. Secondary market activity is relatively low because investors mainly buy to hold. SDLs are eligible as collateral for RBI funding.</p> <p>As the RCAP-LCR assessment did not provide an HQLA classification for SDLs and as the Basel NSFR standard relies on the Basel LCR standard for such securities, a purely mechanistic categorisation of the SDLs according to the Basel NSFR standard would require an 85% RSF as "unencumbered securities that are not in default and do not qualify as HQLA (the average residual maturity of banks' SDL holding is more than four years, so that only a small proportion would benefit from a lower RSF due to a shorter remaining maturity).</p> <p>A substance-based assessment would equate the SDLs to HQLA Level 2A or 2B, depending on factors such as inferred rating, central bank eligibility and overall market liquidity. It should be noted that the SDLs are not unrated because the market is not well developed, but because investors perceive the public infrastructure as a sufficient safeguard. Indian rating agencies give a rating to some state-owned entities, revealing that the range of inferred rating of Indian states is between AA– and BB– (on the national rating scale). Regarding liquidity, differentiation in the market between central government debt and SDLs (and between SDLs issued by different states) appears to support the conclusion that SDLs should not be treated as Level 1 HQLA with an RSF of 5%. Rather, an RSF in the range equivalent to Level 2A or Level 2B HQLA (RSF factors 15% or 50%) would appear appropriate.</p> <p>If a 15% RSF factor were to be applied to the unencumbered SDL holdings of banks, the average NSFR decrease would be equal to 0.7 percentage points for the sample of banks. If a 50% RSF factor were to be applied, the average decrease across the sample would be equal to 3.3 percentage points.</p> <p>The Assessment Team estimates that, within this range, the RSF is rather closer to a Level 2A than to a Level 2B RSF due to the eligibility as collateral for RBI refinancing at low haircuts. Overall, the Assessment Team considers a deviation of 1.5 percentage points in the NSFR as a reasonable estimate for the purpose of the materiality assessment.</p> |
| Materiality                          | Material  |
| Basel paragraph number               | 43: non-performing loans  |
| Reference in the domestic regulation | RBI NSFR Circular, paragraph 9.6(e)   |
| Finding                              | <p>The Basel NSFR standard assigns RSF factors of 50% to loans with residual maturity of less than one year, 85% to unencumbered performing loans with residual maturity of more than one year, and 100% to non-performing loans.</p> <p>The definition of performing loans in the Indian regulations differs from the Basel definition. In particular, the past-due period can exceed 90 days, because the definition is linked to harvesting seasons for crop loans, a subcategory of agricultural loans. The effective past-due period depends on the length of a specific crop and can vary from three months to one year.</p> <p>The RCAP-Capital assessment noted that the difference in definitions was a deviation from the Basel standards. At that time, it was not material.</p> <p>The Assessment Team calculated the materiality from an NSFR perspective. In that regard, the impact stems from applying the RSF to performing loans, when in fact the loan would be non-performing because it is past due by more than 90 days. In terms of</p>  |

|             |   |
|-------------|---|
|             | <p>a similar economic impact, the past-due date linked to the harvesting season could lead to a longer effective residual maturity of loans, implying that some proportion of loans with a residual maturity of less than one year should be treated as loans with a residual maturity of more than one year.</p> <p>Data provided by the RBI allowed the Assessment Team to calculate the impact of both scenarios. Using the data on the amount of loans that are considered performing under Indian regulations but would be considered past due if the 90-day criterion was applied, the Assessment Team calculates an approximate average effect of 0.47 percentage points. The Assessment Team used approximations with regard to the increase in RSF, as no information was available on the breakdown between loans maturing in less than one year and those maturing in more than year, implying that the increase in RSF could not be fully determined.</p> <p>The Assessment Team also calculated a materiality impact by focusing on an effective lengthening of maturity. Here, the effect could be modelled by changing the effective maturity of loans with a residual maturity between six months and one year to a residual maturity of one year or more. This results in an increase from a 50% to an 85% RSF factor. The average impact on banks' NSFR is 0.72 percentage points and it is approximately 2.5% for one individual bank.</p> <p>Overall, the Assessment Team believes that the weighted average impact is not larger than 0.72 percentage points. The impact of the assumed lengthening of maturity is quite conservative as it assumes that all loans with a residual maturity between six months and one year are effectively maturing in more than one year, while in fact only a smaller proportion may do so. This would compensate for the impact of the increase in RSF of non-performing vs performing long-term loans (above one year) that is not reflected in this second calculation method.</p> |
| Materiality | Material  |

## 2.2.4 Disclosure requirements

| Section grade                        | Compliant   |
|--------------------------------------|---|
| Basel paragraph number               | 20–22: <sup>4</sup> location of reporting   |
| Reference in the domestic regulation | Not implemented   |
| Finding                              | <p>The Basel NSFR disclosure standard requires banks to publish their Pillar 3 disclosure report in a standalone document or as part of a bank's financial reporting (if certain conditions are fulfilled and if it is clearly "signposted" in the Pillar 3 report).</p> <p>The Indian authorities have not yet implemented the Basel III Pillar 3 requirements, which contain the requirements with respect to signposting. The existing Indian regulations require banks to publish disclosures in their published financial reports or provide a direct and prominent link to the complete disclosure in their websites or in publicly available regulatory reports. However, the RBI expects to implement the signpost requirements when implementing the Basel III Pillar 3 disclosure requirements.</p> <p>Notwithstanding the above requirements for signposting, the Assessment Team concludes that the main priority of the Indian NSFR disclosure regulation is to ensure that the information on NSFR will be disclosed and with the required frequency.</p> <p>Given the existing requirements and future commitments, the Assessment Team assesses this finding as not material.</p> |
| Materiality                          | Not material  |

<sup>4</sup> See BCBS, Revised Pillar 3 disclosure requirements, January 2015, [www.bis.org/bcbs/publ/d309.pdf](http://www.bis.org/bcbs/publ/d309.pdf).

## 2.3 Observations on the NSFR implementation in India

The following observations highlight certain special features of the regulatory implementation of the Basel NSFR standards in India. These are presented to provide additional context and information. Observations are considered compliant with the Basel standards and do not have a bearing on the assessment outcome.

### 2.3.1 Scope, minimum requirement and application issues

|                                      |   |
|--------------------------------------|---|
| Basel paragraph number               | 8: implementation date  |
| Reference in the domestic regulation | RBI NSFR Circular, paragraph 5  |
| Finding                              | <p>The Basel framework expects implementation of the NSFR from 1 January 2018. The Indian regulations come into effect on 1 April 2020.</p> <p>The Assessment Team notes that, as of 31 December 2018, several other Basel Committee members have delayed their implementation of the Basel NSFR standard. The Assessment Team believes that the delay is not expected to have a significant impact on financial stability in India.</p>  |
| Basel paragraph number               | 51: scope of application  |
| Reference in the domestic regulation | RBI NSFR Circular, paragraph 5  |
| Observation                          | <p>The Basel NSFR applies to all internationally active banks and requires internationally active banks to actively monitor and control liquidity risk exposures and funding needs at the level of individual legal entities, foreign branches and subsidiaries and the group as a whole. This is in line with Principle 6 of the Basel Committee's <i>Principles for sound liquidity risk management and supervision</i>, which notes that bank should actively monitor and control liquidity risk exposures and funding needs within and across legal entities.<sup>5</sup></p> <p>However, the Indian NSFR regulations apply to all scheduled commercial banks, which includes more than only internationally active banks. This applies at both the consolidated and solo levels, as well as to foreign branches operating in India. The Indian regulations also make general reference to the Basel Committee's sound liquidity principles, although not to Principle 6, specifically.</p> |

### 2.3.2 Available stable funding

|                                      |  |
|--------------------------------------|--|
| Basel paragraph number               | 18 and FAQ 27: exercise of options   |
| Reference in the domestic regulation | RBI NSFR Circular, paragraph 8.2   |
| Observation                          | <p>The Basel NSFR standard requires that supervisors consider reputational factors when determining the maturity of instruments containing options exercisable at a bank's discretion.</p> <p>The Indian regulation does not set out the supervisory process for considering such reputational factors. However, the RBI explained to the Assessment Team that supervisors monitor the treatment of such options and have the power to take action if abnormal treatments were identified. This case-by-case approach is consistent with a clarification provided in the Basel Committee NSFR FAQ. Moreover, banks must obtain prior approval from the RBI to exercise an option linked to capital instruments.</p> <p>Based on discussions with the RBI, the Assessment Team understands that funding instruments with options are in practice subject to scrutiny by RBI supervisors and that the NSFR-specific requirements will also be part of the supervisory process.</p> |

<sup>5</sup> See BCBS, *Principles for sound liquidity risk management and supervision*, September 2008, [www.bis.org/publ/bcbs144.pdf](http://www.bis.org/publ/bcbs144.pdf).

### 2.3.3 Required stable funding

|                                      |  |
|--------------------------------------|--|
| Basel paragraph number               | 29 and FAQ 21: exercise of options   |
| Reference in the domestic regulation | RBI NSFR Circular, paragraph 9.1   |
| Observation                          | <p>The Basel NSFR standard requires that supervisors consider reputational factors when determining the maturity of instruments containing options exercisable at a bank's discretion.</p> <p>The Indian regulation does not set out the supervisory process for considering such reputational factors. However, the RBI explained to the Assessment Team that supervisors monitor the treatment of such options and have the power to take action if abnormal treatments were identified. This case-by-case approach is consistent with a clarification provided in the Basel Committee NSFR FAQ.</p> |

### 2.3.4 Disclosure requirements

|                                      |   |
|--------------------------------------|---|
| Basel paragraph number               | LIQ2: <sup>6</sup> implementation date  |
| Reference in the domestic regulation | RBI NSFR Circular, paragraph 5  |
| Finding                              | <p>The Basel framework expects implementation of the NSFR disclosure requirements from 1 January 2018. The Indian regulations apply the NSFR disclosure requirements only from 1 April 2020.</p> <p>The Assessment Team notes that, as of 31 December 2018, several other Basel Committee members have delayed their implementation of the Basel NSFR standard and therefore also their NSFR disclosure requirements.</p>   |
| Basel paragraph number               | LIQ2: frequency   |
| Reference in the domestic regulation | RBI NSFR Circular, paragraph 12   |
| Observation                          | <p>The Basel NSFR disclosure standard requires semiannual disclosure covering two data points including the latest and previous quarter-ends.</p> <p>The Indian NSFR regulations contain these requirements, but also provide an option for banks with annual reporting to publish NSFR disclosures on an annual basis with information on the previous four quarters.</p> <p>However, banks that are listed in India are required to make quarterly disclosure of financial information according to a clause in the Indian regulation for listed banks. This will also apply for the NSFR when it is implemented in India. Furthermore, banks that are not listed also disclose quarterly, even though they are not formally required to do so.</p> <p>Thus, in practice, the banks will disclose the NSFR quarterly when it is implemented in India. The Assessment Team has recommended that the RBI implement and provide clarity of this practice in their NSFR regulation. The RBI has agreed to make these changes. (These changes are not listed in the Annex, as they are related to an observation.)</p> |

<sup>6</sup> LIQ2 is the name of the NSFR disclosure template. See BCBS, *Pillar 3 disclosure requirements – consolidated and enhanced framework*, March 2017, [www.bis.org/bcbs/publ/d400.pdf](http://www.bis.org/bcbs/publ/d400.pdf).

### 3 Follow-up on the interaction of the LCR and the SLR

The RCAP-LCR assessment recommended that the next RCAP assessment of India again review the interaction between the LCR and the SLR. The SLR is a requirement of Section 24 of the Indian Banking Regulation Act of 1949. It seeks to ensure that banks have adequate liquidity buffers to withstand large withdrawals, similar in effect to the LCR. When implementing the LCR, the RBI chose to maintain the SLR as a matter of prudence.

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. Prescribed assets include cash, gold and government securities. As of 31 December 2018, such assets should not be less than 19.5% of a bank's net demand and time liabilities (NDTL). Non-compliance with the SLR attracts monetary penalties.

The RBI allows for a limited portion of government securities used to meet the SLR to be recognised as HQLA Level 1 through two liquidity facilities:

- the RBI's marginal standing facility (MSF), of up to 2% of NDTL; and
- the "facility to avail liquidity for LCR" (FALLCR), of up to 13% of NDTL.

During the RCAP-LCR assessment, the Assessment Team considered whether the minimum SLR requirement prevented government securities used to meet the SLR from being classified as HQLA for the purposes of the LCR. That team concluded that, while in principle such securities should not be counted, in practice the SLR requirement did not really encumber assets because it does not impede their monetisation in private markets in times of need. This was because the RBI has full power over the SLR and has demonstrated its willingness to allow usage of the SLR assets during an LCR stress event without applying a penalty. Nonetheless, the RCAP-LCR Assessment Team recommended that future RCAP Assessment Teams review the interaction between the LCR and the SLR and consider any changes.

The RCAP-NSFR Assessment Team reviewed the SLR and its interaction with other liquidity ratios. Since the RCAP-LCR assessment was done in 2015, the RBI has lowered the SLR from 21.5% of NDTL to 19.5% and also increased the portion of government securities allowed in the FALLCR from 5% to 13% of NDTL. These changes are implemented in order to adjust the SLR to the phase-in of the LCR, which will be fully phased in with a minimum level of 100% as 1 January 2019. A glide path was announced on 5 December 2018 for reducing the SLR in steps of 25 bp per quarter to reach a level of 18% by April 2020. Besides these changes to the quantification of the SLR requirement, there have been no significant changes to the SLR framework or the specification of the usability of the SLR buffer in a crisis situation since the RCAP-LCR assessment.

Consistent with the Indian LCR framework, government securities held by the bank in excess of the SLR requirement, as well as the proportion of SLR securities recognised in the two liquidity facilities FALLCR and MSF, are considered unencumbered in the NSFR. The RCAP-NSFR Assessment Team concludes, in line with the RCAP-LCR assessment, that in practice the SLR requirement would not encumber assets because the RBI has the powers to relax the SLR requirement or waive penalty fees in times of stress. Therefore, it does not impede the monetisation of the assets in private markets in times of need.

Given the importance of ensuring that HQLA can be used in times of stress, the Assessment Team recommends that the next RCAP assessment should consider the interaction of the SLR with the Basel liquidity standards.



## Annexes

### Annex 1: RCAP Assessment Team and Review Team

#### Assessment Team Leader

|                     |  |
|---------------------|--|
| Mr Vasily Pozdyshev | Central Bank of the Russian Federation |
|---------------------|--|

#### Assessment Team members

|  |  |
|--|--|
| Ms Ana Paula Castro Carvalho               | Central Bank of Brazil                   |
| Mr Ethan Goh (until 31 Dec 2018)           | Basel Committee Secretariat              |
| Mr Joachim Keller                          | National Bank of Belgium                 |
| Ms Anja Krarup Kuhlman (until 28 Jan 2019) | Financial Supervisory Authority, Denmark |

#### Supporting members

|                                      |  |
|--------------------------------------|--|
| Ms Elena Dzigoeva                    | Central Bank of the Russian Federation |
| Ms Louise Eggett (until 31 Dec 2018) | Basel Committee Secretariat            |
| Mr Mark Pocock (from 31 Dec 2018)    | Basel Committee Secretariat            |
| Mr Olivier Prato                     | Basel Committee Secretariat            |

#### Review Team members

|                 |   |
|-----------------|---|
| Mr Neil Esho    | Basel Committee Secretariat                       |
| Ms Dana Green   | Federal Reserve Bank of New York                  |
| Mr Faizel Jeena | South African Reserve Bank                        |
| Mr Qi Xiang     | China Banking and Insurance Regulatory Commission |

## Annex 2: List of Basel standards and implementing regulations issued by the Indian authorities

The following Basel standards were used as the basis of this RCAP assessment:

- *Basel III: the Net Stable Funding Ratio*, October 2014
- *Revised Pillar 3 disclosure requirements*, January 2015
- *Pillar 3 disclosure requirements – consolidated and enhanced framework*, March 2017
- *Implementation of Net Stable Funding Ratio and treatment of derivative liabilities*, October 2017
- *Treatment of extraordinary monetary policy operations in the Net Stable Funding Ratio*, June 2018

Table A.1 lists the regulations issued by the RBI to implement the NSFR in India. Previous RCAP assessments of India's implementation of the Basel standards considered the binding nature of regulatory documents in India.<sup>7</sup> This RCAP Assessment Team did not repeat these reviews, but instead relied on the findings of the previous assessments. Those assessments concluded that the types of instrument described in Table A.1 could be considered as binding on banks and supervisors for the purposes of an RCAP assessment.

Overview of relevant Indian liquidity regulations

Table A.1

| Domestic regulations                                 | Type, version and date   |
|--|--|
| Reserve Bank of India Act and Banking Regulatory Act | Statutes, issued in 1934 and 1949 respectively, which empower the RBI to issue directions or guidelines to banks |
| DBR.BP.BC.No.106/21.04.098/2017-18                   | Guidelines on the NSFR, issued 17 May 2018   |
| DBR.BP.BC.No.08/21.04.098/2018-19                    | NSFR – Final Guidelines issued 29 November 2018  |
| Source: RBI.   |  |

<sup>7</sup> See Annex 7 of the RCAP assessment of the Basel III risk-based capital regulations in India, published in June 2015, [www.bis.org/bcbs/publ/d320.htm](http://www.bis.org/bcbs/publ/d320.htm).

## Annex 3: Key liquidity indicators of the Indian banking system

Overview of Indian banking sector liquidity as of 31 March 2018

Table A.2

| Size of banking sector (Indian rupees, millions)  |                    |                   |
|---|--------------------|-------------------|
| Total exposures of all banks operating in (including off-balance sheet exposures)                             | 165,437,426        |                   |
| Total assets of all locally incorporated internationally active banks   | 66,895,839         |                   |
| Total assets of locally incorporated banks to which liquidity standards under the Basel framework are applied | 142,381,105        |                   |
| Number of banks   |                    |                   |
| Number of banks operating in India (excluding local representative offices)                                   | 103                |                   |
| Number of global systemically important banks (G-SIBs)  | 0                  |                   |
| Number of D-SIBs  | 3                  |                   |
| Number of banks which are internationally active  | 6                  |                   |
| Number of banks required to implement Basel III liquidity standards   | 93                 |                   |
| Number of banks required to implement domestic liquidity standards  | 93                 |                   |
| Breakdown of NSFR for 11 RCAP sample banks (Indian rupees, millions; as of 30 June 2017)                      | Unweighted         | Weighted          |
| Capital   | 11,672,736         | 11,672,736        |
| Stable deposits from retail and small business customers  | 7,737,148          | 7,378,669         |
| Less stable deposits from retail and small business customers   | 36,783,094         | 33,225,404        |
| Unsecured funding from non-financial corporates   | 12,207,465         | 595,0740          |
| Unsecured funding from central banks, sovereigns, PSEs, MDBs and NDBs   | 1,299,853          | 675,771           |
| Unsecured funding from financials (other legal entities)  | 5,157,848          | 2,200,711         |
| Secured funding (all counterparties)  | 5,069,378          | 4,764,561         |
| Other liabilities   | 9,673,015          | 6,026,948         |
| <b>Total available stable funding</b>   | <b>89,600,537</b>  | <b>71,895,539</b> |
| Cash and central bank reserves  | 15,533,489         | 673,271           |
| Loans to financial institutions   | 1,098,820          | 693,597           |
| Securities eligible as Level 1 HQLA   | 17,919,133         | 895,957           |
| Securities eligible as Level 2A HQLA  | 326,940            | 140,603           |
| Securities eligible as Level 2B HQLA  | 78,115             | 39,077            |
| All residential mortgages   | 6,765,611          | 3,855,847         |
| Loans, <1 year  | 13,092,532         | 6,253,982         |
| Other loans, >1 year, risk weight<=35%  | 4,402,390          | 2,626,976         |
| Loans, risk weight>35%  | 12,401,213         | 10,044,417        |
| Derivatives   | 207,531            | 204,791           |
| All other assets  | 20,986,065         | 20,243,794        |
| Off-balance sheet   | 17,795,769         | 847,961           |
| Total required stable funding   | <b>110,564,372</b> | <b>46,520,273</b> |
| NSFR  | 81.03%             | 154.5%            |

Source: RBI.

## Annex 4: Materiality assessment

The outcome of the RCAP assessment is based on the materiality of the findings described in Section 2.2 and summarised in Table A.3. Assessment Teams evaluate the materiality of findings quantitatively where possible, or using expert judgment when the impact cannot be quantified.

The materiality assessment for quantifiable gaps is based on the cumulative impact of the identified deviations on the reported NSFRs of banks in the RCAP sample, as listed in Table A.4.

| Number of deviations by component                 |              |                      | Table A.3 |
|---|--------------|----------------------|-----------|
| Component   | Not material | Potentially material | Material  |
| Scope, minimum requirement and application issues | 0            | 0                    | 0         |
| Available stable funding (numerator)              | 0            | 0                    | 0         |
| Required stable funding (denominator)             | 0            | 0                    | 2         |
| NSFR disclosure requirements                      | 1            | 0                    | 0         |

| RCAP sample banks    |   | Table A.4 |
|----------------------|---|-----------|
| Banking group        | Share of banks' assets in the total assets of the Indian banking system<br>(%, as of 31 March 2018) |           |
| Bank of Baroda       | 4.68  |           |
| Bank of India        | 3.98  |           |
| Canara Bank          | 4.02  |           |
| Corporation Bank     | 1.41  |           |
| Indian Overseas Bank | 1.51  |           |
| Punjab National Bank | 5.13  |           |
| Union Bank of India  | 3.18  |           |
| State Bank of India  | 22.10   |           |
| Axis Bank Limited    | 4.81  |           |
| HDFC Bank Ltd        | 7.17  |           |
| ICICI Bank Limited   | 6.20  |           |
| Total                | 64.20   |           |

Source: RBI. For this purpose, banking assets are based on the measure of total exposures used in the leverage ratio, which includes both on- and off-balance sheet exposures.

## Annex 5: Rectifications made by the RBI

| List of rectifications by the RBI |  |   | Table A.5 |
|-----------------------------------|--|---|-----------|
| Basel paragraph                   | Reference in Indian regulations                                    | Description of the rectification  |           |
| 8, LIQ2                           | DBR.BP.BC.No.08/2<br>1.04.098/2018-19<br>dated 29<br>November 2018 | Implementation date introduced. NSFR will come into effect from 1 April 2020. |           |
| Source: RBI.                      |  |   |           |

## Annex 6: Issues for follow-up RCAP assessments

The Assessment Team identified the interaction between the Indian LCR & NSFR requirements and the Indian Statutory Liquidity Ratio (SLR) liquidity requirements for follow-up and review in future RCAP assessments.

## Annex 7: Areas where the Indian rules are stricter than the Basel standards

In some areas, the Indian authorities have adopted a stricter approach than the minimum standards prescribed by the Basel Committee. These are listed below for information. The stricter rules have not been taken into account as mitigants for the overall or component-level assessment of compliance.

- The Basel NSFR standard applies only to internationally active banks. However, the RBI applies the NSFR to Indian banks at the solo and consolidated level, and for foreign banks operating as branches on a standalone basis (ie for Indian operations only) in India.

## Annex 8: Elements of the NSFR subject to national discretion

Implementation of national discretions by RBI

Table A.6

| Basel paragraph | Description   | National implementation  |
|-----------------|---|--|
| 25(a)           | Treatment of deposits between banks within the same cooperative network                         | The RBI has decided not apply the national discretion in the Basel standard to exclude deposits between banks within the same cooperative network from liabilities receiving a 0% available stable funding factor.   |
| 31              | Treatment of excess collateral in a covered bond collateral pool allowing for multiple issuance | Covered bonds are not a feature of the Indian financial markets and the RBI is yet to examine the regulatory and market-related aspects of introducing covered bonds in the financial markets. As such, it does not apply the national discretion providing more favourable treatment of covered bond collateral.                        |
| 31, 36          | Treatment of central bank operations  | The RBI has assigned 0% RSF factor for all central bank reserves.  |
| 43              | RSF factor for derivative liabilities   | The RBI has set the RSF factor for derivative liabilities at 5%. This reflects the low level of derivatives activity within the Indian financial system, the desire of the Indian authorities to promote the use of derivatives and analysis by the RBI of the effect of different RSF factors on derivative liabilities on banks' NSFR. |
| 45              | Treatment of interdependent assets and liabilities  | The RBI does not apply the exceptional treatment included in the Basel standard to determine whether certain asset and liability items, on the basis of contractual arrangements, are interdependent.  |
| 47              | RSF factors for other contingent funding obligations  | The RBI has used the discretion of assigning 3% RSF factor for trade finance-related obligations (including guarantees and letters of credit) and guarantees and letters of credit unrelated to trade finance obligations.   |
| 50              | Scope of application of NSFR and scope of consolidation of entities within a banking group      | The RBI has made the NSFR applicable to all scheduled commercial banks operating in India (excluding regional rural banks) on a solo and consolidated basis. Further it is also applicable to foreign banks operating as branches in India on a standalone basis (ie for Indian operations only).  |

Source: RBI.