TARGET PRELIMS 2024
BOOKLET-26; ECONOMY-7
CA OF RBI, BANKING AND FINANCIAL SECTOR-2

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2. RBI'S FUNCTIONS

1) WITHDRAWAL OF RS 2,000 BANK NOTES

- **Why?**
  - » The Rs 2,000 denomination banknotes was introduced in Nov 2016 under section 24(1) of the Reserve Bank of India Act, 1934. This was done to meet the currency requirement of the economy in expeditious manner after withdrawal of Rs 5,00 and Rs 1,000 notes. Once enough new 5,00-rupee notes were in circulation, **printing of Rs 2,000 banknotes was stopped in 2018-19**.
  - » So, a majority of the Rs 2,000 banknotes were issued prior to March 2017 and were at the end of their estimated lifespan of 4-5 years.
  - » It was also noticed that this denomination was not commonly used for transactions.
  - » Further, the stock of banknotes of other denominations continues to be adequate to meet the currency requirement of the public.
  - » In view of the above, and in pursuance of the **clean note policy** of the RBI, it was decided to withdraw Rs 2,000 denomination banknote from circulation.
- **What is Clean Note Policy?**
  - » Under this policy RBI ensure availability of Good Quality Bank notes to members of the public.
- The Rs 2,000 Bank notes could be deposited/ exchanged till Sep 30, 2023. It was later extended till 7th Oct 2023.
- After 7th October, the Rs 2,000 banknotes could continue to be exchanged by individuals/ entities at the **19 RBI Issue Offices** up to a limit of Rs 20,000 at a time. Individual/Entities can also tender Rs 2,000 banknotes at the 19 RBI Issue offices for credit to their bank account in India for any amount.
- **Impact:**
  - » The **growth in currency in circulation** decelerated to 3.7% for the week ending 9th Feb 2024 from 8.2% a year ago.
    - ▫ **Note:** Currency in Circulation (CiC) refers to notes and coins in circulation, while currency with the public comprises notes and coins in circulation minus cash with banks.
- **Some Rs 2,000 notes still in circulation** (Dec 2023)
  - » **About 2.7% of withdrawn note** are still in circulation.
    - ▫ On 19th May 2023, around Rs 3.56 lakh crore banknotes of Rs 2,000 were still in circulation. This has declined to Rs 9,760 crores (2.7%) on 30th Nov 2023.
- **Note**: Rs 2,000 banknotes **continue to remain legal tender**.

2) RBI'S REPORT ON CURRENCY AND FINANCE 2022-23: TOWARDS A GREENER AND CLEANER INDIA (MAY 2023)

- The report is one of the most comprehensive attempts by central regulator to discuss the responsibility of banking and finance sector to the plethora of challenges posed by **climate emergency**.
- **Theme:** Towards a Greener and Cleaner India
- The report claims that fiscal policy has a prominent role in driving the green transition, from fossil fuels to renewables, and highlight the urgent need for a green taxonomy, a classification system that determines whether an investment is sustainable or not.
- The three areas where RBI sees a role for itself**:**
  - i. **Mandatory disclosure requirements** pertaining to climate related risks of banks
  - ii. **Mandating financial institutions** to incorporate environmental risk factors in their risk management process
  - iii. **Green Asset Ratio** (GAR), i.e., the proportion of total assets invested in sustainable projects or economic activities - prescribing financial institutions to maintain threshold level.

3. FINANCIAL INCLUSION

- **What is financial inclusion?**
  - » Financial inclusion is defined as the process of **ensuring access to adequate financial services (Banking, Credit, Investment, Insurance)** in a cost effective and timely manner for vulnerable and low income groups.
- **Advantages:** Economic growth; Social Benefits; Reducing Inequalities; efficiency in implementation of government schemes; protects low-income households (from money lenders, Ponzi schemes) etc.
- **Key steps taken so far to promote financial inclusion**
  - **Nationalization of Banks** in 1969 and 1980 was **Region-focused** on ensuring that the banking services reach rural areas.
  - **Promotion of alternatives** Rural Banks, Cooperatives, etc. have also contributed to Financial inclusion.
  - **Lead Bank Scheme** - RBI assigns a district to a particular bank. The bank is responsible for promoting banking services and financial literacy in that district.
  - **Pradhan Mantri Jan Dhan Yojana (PMJDY)**, under which 43 crore accounts have been opened by Aug 2021.
  - **Niche Banking:** Setting up of Small Financial Banks and Payments Banks.
    - Launch of India Post Payment Bank in Sep 2018 is particularly significant in bridging the gap in last mile connectivity.
  - **Priority Sector Lending** initiative of RBI
  - **Various saving schemes under post office**
  - **Various Insurance and Pension initiatives**
    - Schemes such as the **Pradhan Mantri Suraksha Bima Yojana** to provide accidental death or disability cover and **Atal Pension Yojana** to provide pension cover to subscribing bank account holders.

1) PMJDY

- **Introduction**
    - » Financial inclusion is a crucial component of inclusive growth. But, even in the year 2014, more than 40% of the households in the country didn't have a bank account. In the absence of an account, they mostly depended on local money lenders for credit purposes at very high interest rates. Further, a very small percentage of bank loans used to go to rural area.
    - » To remedy these problems, PM Modi announced PMJDY in his independence day speech on 15th Aug 2014 and the scheme was launched on 28th Aug 2014.

- **Objectives:**
    - » Ensure access of **financial products & services** at an affordable cost.
    - » Use of technology to lower cost and widen reach.

- The scheme is aimed at providing key financial inclusion services like banking facilities, financial literacy, insurance cover etc. to all the ~~households~~ **(adult individuals)** in the country. Further, the government also envisaged channeling all government benefits (Central, state and local government) to the beneficiary's accounts and promoting government's DBT initiative.

- **Eligibility**
    - » Any person who is Indian citizen above the age of 10 and does not have a bank account can open an account with zero balance. It also provides for a relaxed KYC norm.

- **Six Pillars of PMJDY (National Mission on Financial Inclusion)**
    i. **Banking Service in every 5 kilo meters**
        - The country has been divided into a number of Sub Service Areas (SSA), each with 1000-1500 households. One banking outlet (branch or BC) have been established within a distance of five km from every SSA.

    ii. **Account for each ~~family~~ Individual**
        - Bank account for each adult individual with **accident insurance** of Rs ~~1,00,000~~ **2,00,000** for Rupay debit card holders and **overdraft** facility of Rs ~~5,000~~, **Rs 10,000**.

    iii. **Financial Literacy**

    iv. **Credit Guarantee Funds** to cover potential defaults in overdrafts;

    v. **Micro Insurance:**
        - Accidental insurance cover on RuPay cards holders has been increased from Rs 1 Lakh to Rs 2 Lakh for PMJDY accounts opened from 28.8.2018.

    vi. **Pension Transfers:** Pension payments under the Swavalamban Yojana scheme for workers in the unorganized sector is being paid through bank accounts.

- **Other Features**
    - » Zero balance accounts etc.

4. INITIATIVES FOR CASHLESS ECONOMY

1) DIGITAL BANKING (PROMOTING LESS CASH ECONOMY)

- **What is less cash / cashless economy?**

- » Cashless economy refers to a scenario when monetary transaction in an economy happens mostly electronically and use of cash is absent or negligible.

- **Advantages:**
  - » **Cash economy is expensive**
  - » **Fighting Corruption** through transparency in money flow.
  - » **Increased tax compliance and thus tax revenue**
  - » **Financial inclusion** -> A cashless economy would mean everyone is having a bank account and thus financial inclusion is a pre-requisite for cashless economy.
  - » **Reduced chances of petty crimes** like theft, snatching etc.
  - » **Environment Friendly**: Reduced use of paper money can contribute to environmental benefits as well by reducing the need of trees to by cut.

- **Evolution of Digital Payment in India**
  - » Digital Payments system in India has been **steered by the Reserve Bank of India (RBI).** It first published the ***Payment Systems in India,*** in 1998.
  - » **RTGS - Real Time Gross Settlement System** was launched by RBI in 2004. **NEFT (National Electronic Funds Transfer)** was introduced in 2005.
  - » **NPCI** functions under the **Payment and Settlement Systems Act, 2007** in order to create a **robust payments and settlement infrastructure for India**. It is a not-for-profit organization set up under the section 8 of the Companies Act, 2013.
    - ▪ Several of its initiatives like IMPS, UPI, Rupay, e-RUPI etc. have played a crucial role in promoting cashless economy in India.

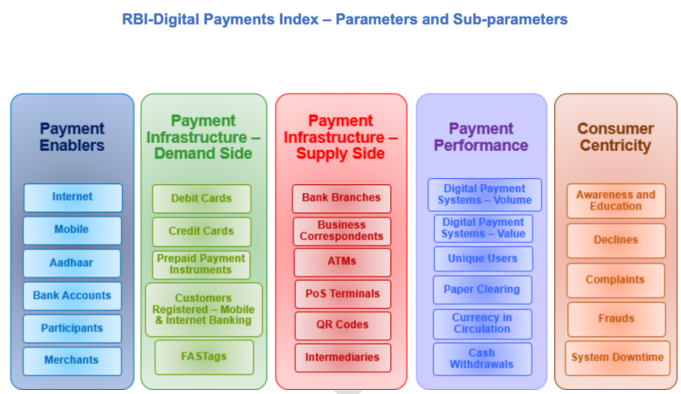
- **Steps taken in India.**
  - » **Key Policy Measures**
    - ▫ **Demonetization** has nudged citizens towards digital payments.
    - ▫ **PMJDY** has ensured bank accounts and Rupay Debit cards with almost all households in the country, increasing the scope of cashless economy.
    - ▫ **Various initiatives for digital literacy like** PMDISHA
    - ▫ Further, RBI has also announced that **all charges for NEFT and RTGS collected from banks** will be waived off from 1st July 2019, and have asked banks to pass on the benefits to customers.
    - ▫ **No MDR payment charges on payment via RUPAY, UPI from 1st Jan 2020** (Dec 2019)
    - ▫ **E-RUPI**
    - ▫ **CBDC**

- **Technological Measures:**
  - » Increasing **penetration of internet and smart phones**
  - » **Fintech Revolution** -> coming up of large number of fintech companies and facilities like PayTm Google Pay etc.
  - » Various initiatives by NPCI - IMPS, UPI, BHIM, RuPay, AEPS, e-RUPI etc.
  - » In Dec 2019, RBI operationalized round-the-clock **(24X7) availability of the National Electronic Fund Transfer (NEFT)** and asked the **banks not to levy any charge on NEFT transfer from saving bank account holders**.

- Deepening of Payment revolution in India is a result of political will (PMJDY), a proactive central bank and use of technology.

- **Nandan Nilkeni Panel recommendations for strengthening of the digital payment industry (June 2019)**

- The **Digital Payments Index of RBI** captures the extent of digitization of payments across the country.
    - The index captures (i) Payment Enablers (weight 25%), (ii) Payment Infrastructure – Demand-side factors (10%), (iii) Payment Infrastructure – Supply-side factors (15%), (iv) Payment Performance (45%) and (v) Consumer Centricity (5%).



    - The RBI-DPI has been **constructed with March 2018 as the base period**, i.e. DPI score for March 2018 is set at 100.
        - The DPI for March 2019 and March 2020 work out to 153.47 and 207.84 respectively, indicating appreciable growth.
    - The Digital Payments Index **increased from 100 in March 2018 (base period) to 304.06 in September 2021**

2) UPI AND RELATED UPDATES

- **Why in news?**
    - RBI has raised the limits on UPI payment transactions for educational and healthcare purposes (Dec 2023)

- **Introduction**
    - UPI is a real time payment system that allows money transfer between any two bank accounts by using a mobile device. It was developed by NPCI and is controlled by RBI and IBA (Indian Bank Association).
    - UPI has been build using **IMPS** payment architecture system and hence transactions are very fast.
    - It was launched in April 2016.
        - UPI allows a customer to pay directly from a bank account to different merchants, both online and offline, without the hassle of typing credit card details, IFSC code or net banking/wallet password.

- **How Safe is UPI**
    - The UPI is as much secure as internet banking or mobile banking.
    - A **two-step authentication** is used
        - To open the UPI app, you have to give a pin
        - To transfer the money, again you have to enter the MPIN (Mobile Banking Personal Identification Number) or UPI PIN

- It is safe as customers only share a Virtual Payment Address (VPA) and provide no other sensitive information. Receiver won't get your bank account details.
- Only while connecting your bank account to UPI, you have to authenticate it through the card details and OTP.

- **Transaction limit**
  - The transaction limit for UPI is capped at Rs 1 lakh, except a few categories like capital market (AMC, Broking, Mutual Funds etc.), Collections (Credit Card Payments, Loan Repayments, EMI), Insurance etc, where the transaction limit is 2 lakh.
  - In Dec 2021, transaction limit for UPI payments for Retail Direct Scheme and for IPO subscriptions was increased to Rs 5 lakhs.
  - **In Dec 2023**, To encourage the use of UPI for medical and educational services, it is proposed to enhance the limit for payments to hospitals and educational institutions from ₹1 lakh to ₹5 lakh per transaction

- **Benefits of UPI**
  - UPI is revolutionary. It had made the banking transaction a breeze. Former RBI governor Rajan considered the launch of UPI as the Whatsapp moment.
    i. **24X7 Immediate transfer**
       - **No restriction of holiday or working hours. The bank strikes also doesn't affect UPI**
       - **No need to wait for 24 hours to send money to new recipient**
    ii. **Simple:** No need of bank account number and IFSC code of the recipient
    iii. **Less costly:** A transaction through UPI is much cheaper than the other methods.
    iv. **Many bank accounts can be connected to one VPA:** However, the BHIM app only links one account at a time
    v. **Enabled many apps**: PhonePe, BharatPay, PayTM etc. .
    vi. **Benefits of UPI over IMPS:** No need of bank account details and IFSC code (both required in IMPS)
    vii. **Benefits over other mobile wallets**
       - No need of transfer of money into wallet, so always getting interest on the money.
       - Mobile wallets generally allow transfer between wallets, here the transfer can be between different banks.

- **Other key terms associated with UPI**
  - **Virtual Payment Address (VPA)**
    - The UPI system does not use the bank account details of the recipient. But, there should be **an accurate identification** of the money recipient. Ultimately, all this convenience is fruitful if the money goes in right hands.
    - So, every user of the UPI app must have a unique ID. This unique ID is called the Virtual Payment Address (VPA).
      - This VPA would be something similar to sanket@icici, anshu@bob etc. So very easy to remember.

- The app provider bank would allot the VPA to each user. You can choose the VPA similar to the mail address.
- You can give this VPA to anyone to receive money. This app would itself keep storing the VPAs of the person to whom you have transferred the money. It is like saving contact in Gmail.

A) KEY CHANGES MADE IN DEC 2023:

- In Dec 2023, RBI **increased the limits for UPI Transactions for payments made to hospitals and educational institutes** to **Rs 5 lakh** per transaction
- **E-Mandate limit** has also been increased from Rs 15,000 to Rs **1 lakh**.
  - **Background**: The framework for processing of e-mandates for recurring transactions was introduced in Aug 2019 to balance the safety and security of digital transactions with customer convenience. UPI Mandate cane be used in scenario where money is to be transferred later by providing commitment at present. It is used for recurring payments to buy mutual funds, pay insurance premiums and credit card repayments. The limits for **execution of e-mandates** without Additional Factor Authentication (AFA) currently stands at Rs 15,000.
  - **Need of increase**: In categories such as subscription to mutual funds, payments to insurance premium and credit card bill payments, where the transaction size is more than Rs 15,000, a need to enhance the limit has been expressed.
  - **RBI** has therefore, **proposed to exempt he requirement of AFA for transactions** upto Rs 1 lakh for the following categories viz. subscription to mutual funds, payment of insurance premium and payment of credit card bills.
  - This change in limit is expected to increase the usage of e-mandate.

- **Other Related Changes**:
  - RBI has proposed to set up a **fintech repository** to keep track of increasing linkages among banks, NBFCs and fintech.
    - For better understanding of the developments in the FinTech ecosystem with an objective to appropriately support the sector, it is proposed to set-up a Repository for capturing essential information about Fintechs, encompassing their activities, products, technology stack, financial information etc.
    - This **fintech repository** will be set up by Reserve Bank Innovation Hub by April 2024.

  - **Establishment of Cloud Facility for the Financial Sector in India**:
    - **Banks and financial entities** are maintaining an ever-increasing volume of data. Many of them are utilizing various public and private cloud facilities for this purpose.
    - **RBI** is working on establishing a cloud facility for the financial sector in India. This proposed facility will enhance security, integrity and privacy of the financial sector data.
    - The cloud facility will be set up and initially operated by **Indian Financial Technology & Allied Services (IFTAS)**, a wholly owned subsidiary of RBI. Eventually, this cloud facility will be transferred to a separate entity owned by the financial sector participants.

  - **Regulatory Framework for Web-Aggregation of Loan Products**:
    - **Background**: The RBI had accepted the recommendation of the Working Group on Digital Lending (Chairman: Shri Jayant Kumar Dash) to come up with regulatory framework for web-

aggregators of loan products (WALP). WALP entails aggregation of loan offers from multiple lending of an electronic platform which enables the borrowers to compare and choose the best available option to avail loan from one of the available lenders.

- Based on this recommendation, **RBI has decided to bring such loan aggregation services** offered by the Lending Service Providers (LSPs) under a comprehensive regulatory framework.

1) CENTRAL BANK DIGITAL CURRENCY (CBDC) (DIGITAL RUPEE OR E-RUPEE)

- **Why in news?**
  - The RBI has set no-specific timeline for the '**full-fledged**' launch of its **Central Bank Digital Currency (CBDC)** or the e-Rupee (March 2024)
    - RBI Governor Shaktinath Das said that they are in no great hurry to launch the digital currency because they want to be absolutely sure about the **safety, robustness, and the integrity** of digital currency.

- **Basics:**
  - First announced in Budget 2022-23
  - In 2022, the RBI introduced India's own Central Bank Digital Currency (CBDC) which is a digital representation of sovereign currency.
  - RBI defines CBDC as the **legal tender issued by Central Bank in digital form**. It is akin to sovereign paper currency but takes a different form, exchangeable at par with the existing currency and shall be acceptable as a medium of payment, legal tender, and a safe store of value. It would also appear as **liability on a Central Bank's balance sheet**.

- **Key Motivations behind CBDC:**
  - Reduce Operational Cost involved in physical cost management
  - Foster Financial inclusion
  - Efficiency and Innovation in payment system
  - Adding efficiency to settlement system
  - Boosting innovation in cross border payments.
  - Countering Private Crypto Currencies
- Thus, it has all the advantages which any private virtual currency has.
- **How secure is RBI's CBDC?**
  - It operates on the robust foundation of **blockchain technology**, employing encryption and decentralized ledgers to safeguard financial transactions.

- **How does Digital Rupee work?**
  - The RBI will **create tokens**, and issue them to financial entities called **Token Service Providers** (TSPs), which are the banks selected for the Digital Rupee Program. The TSPs will then distribute the tokens to interested parties/customers. The digital rupee tokens will work in the same way as bank notes/coins, and you can use them in lieu of cash.
  - e₹ will work in the same way as bank notes and coins – if you possess them, you can use them in lieu of cash. You may store e₹ in your bank's e₹ app. The digital wallet works in the same way as your cash wallet, except these transactions will be entirely paperless. You can **either conduct e₹ transactions anonymously**, simply by obtaining the sender/receiver's phone number or QR code, or you can opt for account-based e₹ transactions.

- How is e-rupee different from UPI or other fund transfer modes?
  - » UPI/NEFT/RTGS/IMPS are <u>all forms of digital payments</u>. **<u>e₹ is a digital form of currency and is a legal tender provided by RBI</u>** that is **<u>similar to physical cash, but in a digital from</u>**.

- **How is CBDC different from Bitcoin** and other private cryptocurrency?
  - » **<u>RBI takes responsibility for ensuring the transactions</u>** <u>are settled</u>. In bitcoin, the transaction between parties are <u>settled by a pool of users</u>.
  - » **Stability**: E-Rupee enjoys the same stability in value as the rupee while <u>cryptocurrencies can be very volatile</u>.

- **Types of CBDC:**
  - » RBI released **<u>two versions of the Digital Rupee</u>** - **CBDC-Wholesale** (CBDC-W) and **CBDC-**Retail (CBDC-R).
    - **CBDC-W** is designed for <u>limited access</u> and is primarily intended for <u>selected financial institutions</u>. It is used for <u>settlement of inter-bank transfers</u> and related wholesale transactions.
    - **CBDC-R** is available for <u>broader audience, including private sector entities, non-financial consumers, and business of all sizes</u>. It is basically an <u>electronic version of cash</u> primarily meant for retail transactions.
      - The CBDC-R pilot currently <u>enables person-to-person</u> (P2P) and <u>Person to Merchant (P2M) transactions</u> using Digital Rupee wallets provided by pilot banks.

- **Important Proposed features of e-rupee**
  1. Enabling <u>digital transaction even when customers are offline</u>.
     - CBDC-R will soon support offline transactions in areas with <u>limited or no internet connection</u>. Various offline solutions (proximity and non-proximity based) across hilly areas, rural and urban locations will be tested for this purpose.
  2. Integrating the <u>e-rupee with India's widely used UPI</u>.
     - RBI is actively encouraging banks to make the e-rupee interoperable with UPI through QR code system. Some banks like <u>SBI have already implemented the inter-operability feature</u>.
  3. **Programmability**: It will permit users like, for instance, government agencies to ensure that payments are made for <u>defined benefits</u>.
     - It will also permit <u>corporates to program specified expenditures like business travel for their employees</u>.
     - **<u>Additional features like validity period or geographical areas</u>** within CBDC may be used and can be programmed.
  - The above functionalities will be <u>introduced in pilot in gradual manner</u>.

- **What are the denominations of retail e-rupee?**
  - The retail e-rupee is available in various denominations, including 50 paise, 1, 2, 5, 10, 20, 50, 200, 500, and 2000. In contrast, the wholesale e-rupee doesn't specify any specific denomination.

- **Progress so far:**
  - RBI has launched pilots of CBDC in both wholesale and retail segments.
    - **The pilot in wholesale segment**, known as the **Digital Rupee - Wholesale (e₹ -W),** was launched on Nov 1, 2022, with use case being limited to the settlement of secondary market transactions in government securities.
    - The **pilot in retail segment**, known as **digital Rupee - Retail (e₹-R),** was launched on Dec 01, 2022, within a closed user group (CUG) comprising participating customers and merchants.
      - **The e₹-R** is in the form of digital token that represents legal tender. It is being issued in the same denominations as the paper currency and coins. It is being distributed through financial intermediaries, i.e., the banks.
      - **Users** will be able to transact with e₹-R through a digital wallet offered by the participating banks. Transactions can be both person to person (P2P) or Person to Merchant (P2M).
      - It offers features of physical cash like trust, safety and settlement finality. Like cash, the CBDC will not earn any interest and can be converted to other forms of money, like deposits with banks.

- **As of March 2024**, the size of the pilot project is very large. India currently has about **4.3 million retail users of CBDC**. An additional 40,000 merchants are also using the e-rupee.

2) E-RUPI

- **Why in news?**
  - » RBI expands the scope of e-RUPI digital voucher: Non-banking prepaid payment instrument companies can now issue vouchers (June 2023)

- **Details**
  - » E-RUPI is a one time, cashless and contactless instrument for digital payment. It is a QR code or SMS string-based **e-Voucher**, which is delivered to the mobile of beneficiaries. The beneficiary can go and redeem it at any centre that accepts it. It is a person specific, even purpose specific digital voucher.

- It connects the sponsors of the services with the beneficiaries and service providers in a digital manner without any physical interface. It also ensures that payment to the service provider is made only after transaction is complete.
  - » It is pre-paid in nature and thus ensures timely payment to the service provider without involvement of any intermediary.
  - » It will contribute in leak-proof delivery of welfare services and thus would make DBT more effective.
- The user will be able to redeem the voucher without a card, digital payment app or internet banking access, at the service provider.
- **Where all can it be used?**

- » It can also be used for delivering services under schemes meant for providing drugs and nutritional support under Mother and Child Nutrition Scheme, TB Eradication Program, drugs & diagnostics under schemes like AB-PMJAY, fertilizer subsidy etc.
  - » Even the private players can leverage these vouchers as part of their employee welfare and CSR programs.
- **It has been developed by NPCI on its UPI Platform**, in collaboration with the Department of Financial Services, MoH&FW and National Health Authority.

- **Which banks can issue e-RUPI?**
  - » **NPCI has partnered with 11 banks for e-RUPI transactions.** They are Axis Bank, Bank of Baroda, Canara Bank, HDFC Bank, ICICI Bank, India Bank, Indusland Bank, Kotak Mahindra Bank, Punjab National Bank, SBI and Union Bank of India.
  - » The acquiring apps are Bharat Pe, BHIM Baroda Merchant Pay, Pine Labs, PNB Merchant Pay and YoNo SBI Merchant Pay. More banks are expected to join the e-RUPI initiative soon.
- **Advantages for Consumers:** No need of bank account (which is needed in other forms of digital payments); Easy, contactless two-step process that doesn't require sharing of personal details; it can also operate on basic phones and without internet.
- **Advantages for Sponsors:** Strengthen DBT and make it more transparent;
- **Advantages for service providers**: since these are pre-paid vouchers, it would ensure real time payment to the service providers.
- **Are there global examples of a voucher-based welfare system?**
  - » School voucher systems in USA, Colombia, Chile, Sweden, Hong Kong, etc.
  - » In the US, there is a system of education vouchers or school vouchers, which is certificate of government funding for students selected for state-funded education to create a targeted delivery system. These are essentially subsidies given directly to parents of students for the specific purpose of educating their children.
- **Updates: June 2023**
  - » **At present**, purpose-specific e-vouchers are issued by banks of central and state governments to a limited extent on behalf of the corporates.
  - » **Now**, RBI has proposed to expand the scope and reach of e-RUPI vouchers by (a) permitting non-bank Prepaid Payment Instrument (PPI) issuers to issue e-RUPI vouchers and (b) enabling issuance of e-RUPI vouchers on behalf of individuals.

5. NON-PERFORMING ASSETS (NPAS)

1) NON-PERFORMING ASSETS - BASICS

- » Assets in a banking system comprises of loans given and investments (in bonds etc.) made by banks as these earn interest/profit for banks.
- » If the interest/ principal instalment of a loan is not paid until due date, it is called **bad loan**.
- » An asset including a leased asset, becomes non-performing when it ceases to generate income for the bank.
- » According to RBI **A Non-Performing Asset** is a loan or advance where instalment/interest is due for more than **90 days** in case of a term loan or overdraft account/ credit account. Similarly in case of

agriculture loans an account becomes an NPA if the instalment/interest remains overdue for two crop season for a short duration crop, or one crop season for a long duration crop.

- **Stressed Assets** refers to all NPAs plus restructured assets plus written off assets.
- **NPA Classifications**: Banks are required to classify NPAS into one of the following three categories.
    - **A substandard asset** is an asset classified as an NPA or **less than 12 months**.
    - **A doubtful asset** is an asset that has been non-performing for **more than 12 months**.
    - **Loss assets** are loans with losses identified by the bank, auditor, or inspector that need to be fully written off.

2) WHY NPAS INCREASED SO MUCH IN LAST DECADE?

I. **Credit Boom in mid 2000s and then the global financial crisis**: In Mid 2000s large corporates were granted loans based on extrapolation of their recent growth and performance. But with stagnating economic growth due to Global financial crisis, their loan returning capabilities decreased.

II. **Indian creditors used the strategy of "Giving time to time" and hoped that economic revival will reduce NPAs -> this only led to evergreening of NPAs.**

III. **Poor Recognition:** Banks were initially reluctant to recognize NPAs. The true extent of NPA problem only started becoming clear once the RBI initiated the Asset Quality Review in 2015.

IV. **Poor Governance and Regulation of Banks - Crony Capitalism - Poor Recovery**

V. **Lack of specialization of banks in recovering bad loans / NPAs**

VI. **Other Factors which negatively impacted businesses**
- **Key Judicial Decisions**
    - Judicial decisions like abrupt cancellation of coal mines and spectrum allocation led to reallocation through expensive auctioning procedure and thus proved to be a fatal burden on respective business models of power, steel and telecom.
- **Land Acquisition and environmental clearance issues** also blocked a number of projects and contributed towards increasing NPAs.

VII. **Insolvency and Bankruptcy Procedure** had not proved very effective yet.

VIII. **Absence of strict action against bank frauds of high magnitude**
- This is because of absence of a strong law against wilful defaulters and fraudsters

3) IMPACT OF HIGH NPAS

- **On Banking Sector**: Decreased income; downgrading of credit rating; negatively impacts achievement of capital adequacy; reduced competitiveness of PSBs to private banks.
- **Hinders Economic Growth**: Reduction in bank credit; higher interest rates.
- **On Government**: Increased fiscal burden due to the need of recapitalizing PSBs.
- **On Individuals/ Society**
    - **Relatively expensive loans** and decreased interest on deposits.

- » Less budget/credit available for social welfare programs.
- » Eventually its common man's money in the form of deposits which have been lend by banks and is put at risk in case the bank fails.

4) BALANCESHEET SYNDROME WITH INDIAN CHARACTERISTICS

- High NPAs (TBS problem) have derailed growth in other countries. But huge NPAs have not had as huge an impact as in case of other countries. This is being considered 'Balance Sheet Syndrome with Indian Characteristics.'
  - » This is because the NPA's are concentrated in **public sector banks** which not only hold their own capital but are ultimately backed by the government who would eventually come to save these banks in case situation gets out of hand. Therefore, creditors have retained confidence in the banking system and there have been no bank runs, no stress in the inter-bank market etc.
  - » Mid 2000s boom had created **enough infrastructure** (in India's severe supply constraint economy), that there was ample room for the economy to grow after the GFC.

5) STEPS TO REDUCE NPA PROBLEM

4R Strategy: Recognition, Recapitalization, Resolution, Reform

- **Steps Taken So Far**
  1. **Know your customer (KYC)** norms have been strengthened.
  2. **Early identification and reporting of stress** - Special Mention Account (As per revised framework for resolution of stressed assets - Feb 2018)
     - Lenders are required to identify incipient stress in loan accounts, immediately on default, by classifying assets as Special Mention Account (SMA) as per the following categories.

SMA Subcategory	**Basis for classification -** principal or interest payment or any other amount wholly or partly overdue
SMA-0	1-30 days
SMA-1	31-60 days
SMA-2	61-90 days

     - This has to be reported to Central Repository of Information on Large Credit (CRILC) on all borrowers' entities having aggregate exposure of Rs 5 crore and above with them.
  3. **Asset Quality Review by RBI**
     - To deal with the cases of divergences in identification of NPAs or addition provisioning across banks at the central office level
  4. **Indradhanush Scheme**
     - Improving 7 different areas of banks (including capitalization)
  5. **Insolvency and Bankruptcy Code (IBC-2016)**

6. **Fugitive Economic Offenders Act, 2018,** is also acting as a deterrent and may prevent future offenders from running to other countries.
7. **Project Sashakt (**July 2018)
    - It is a five-pronged strategy to resolve bad loans outline - SME resolution approach, bank led resolution approach, AMC/AIF led resolution approach, NCLT/IBC approach and asset trading platform
8. **Prompt Corrective Action (PCA) Framework**
    - **What is PCA?**
        - It is a framework under which banks with weak financial matrices are put under watch by RBI.
        - The framework uses **three parameters** to measure the weakness of a bank:
            - **Capital Ratio**
            - **Asset Quality**
            - **Profitability**
    - **RBI's revised PCA framework for banks applicable from 1st Jan 2022.**
        - The framework would apply on all banks operating in India, including foreign banks operating through branches or subsidiaries based on breach of risk thresholds of identified indicators.
        - **Indicators to be tracked** for capital, asset quality and leverage would be CRAR/Common Equity Tier-1 Ratio, Net NPA Ratio, and Tier 1 Leverage Ratio.
        - **Breach** of any risk threshold may result in invocation the PCA.
        - **Entry:** A bank will generally be placed under PCA framework based on the Audited Annual Financial Results and the ongoing Supervisory Assessment made by RBI.

PCA matrix – Parameters, indicators and risk thresholds

Parameter	Indicator	Risk Threshold 1	Risk Threshold 2	Risk Threshold 3
(1)	(2)	(3)	(4)	(5)
Capital (Breach of either CRAR or CET 1 ratio)	CRAR - Minimum regulatory prescription for Capital to Risk Assets Ratio + applicable Capital Conservation Buffer (CCB) **and/or** Regulatory Pre-Specified Trigger of Common Equity Tier 1 Ratio (CET 1 PST) + applicable Capital Conservation Buffer (CCB)	Upto 250 bps below the Indicator prescribed at column (2) Upto 162.50 bps below the Indicator prescribed at column (2)	More than 250 bps but not exceeding 400 bps below the Indicator prescribed at column (2) More than 162.50 bps below but not exceeding 312.50 bps below the Indicator prescribed at column (2)	In excess of 400 bps below the Indicator prescribed at column (2) In excess of 312.50 bps below the Indicator prescribed at column (2)
	Breach of either CRAR or CET 1 ratio to trigger PCA			
Asset Quality	Net Non-Performing Advances (NNPA) ratio	>=6.0% but <9.0%	>=9.0% but < 12.0%	>=12.0%
Leverage	Regulatory minimum Tier 1 Leverage Ratio	Upto 50 bps below the regulatory minimum	More than 50 bps but not exceeding 100 bps below the regulatory minimum	More than 100 bps below the regulatory minimum

- **RBI's corrective action plan based on risk threshold**
    - RBI can put **mandatory restrictions** on dividend distribution, branch expansion, and management compensation based on the risk threshold.

- In an extreme situation, breach of third threshold, would identify bank as likely candidate for resolution through amalgamation, reconstruction or winding up.
- Further there can be **discretional restrictions** on bank's lending limit, special audit etc.
- RBI can supersede the bank's board, under the PCA.

10. **Governance Reform in banks**
    - E.g. Separation of the post of CMD and Chairman

6) IMAPCT OF THE ABOVE EFFORTS – CURRENT SITUATION

- As per RBI's Financial Stability report released in Dec 2023, **SCB's** gross NPAs ratio continued to decline to a multi-year low of 3.2% and the net Non-Performing Asset (NNPA) ratio to 0.8% in Sep 2023.
- **Why decrease:**
    - » Lower slippages and reduction in outstanding GNPAs through recoveries, upgrades, and write offs led to this decrease.

6. DEVELOPMENTAL BANKS: NEED AND ANALYSIS

- What is a **DFI** (Developmental Financial Institution) or **DFC** (Developmental Finance Company)?
    - » Developmental Financial Institutions provide **long-term credit for capital-intensive investments spread over a long period and yielding low rates of return**, such as urban infrastructure, mining and heavy industry, and irrigation system.
    - » The role of a Development Financial Institution (DFI) is to take cognizance of the gaps in institutions and markets in the country's financial sector and to act as a **gap filler**.

- **Objectives of DFI**:
    - » **Economic Development** of the country via financing infrastructure
    - » They also provide **technical assistance** like Project Reportand Consultancy Services.
    - » They provide credit enhancement for infrastructure and housing projects and help in improving debt flows towards infrastructure projects.

- **History of Development Banks in India**
    - » **Industrial Finance Corporation of India** (IFCI), set up in 1949, was perhaps India's first developmental bank.
    - » In 1955, the World Bank prompted the **Industrial Credit and Investment Corporation of India** (ICICI) - the parent of the largest private bank in India today - as a collaborative effort between the government with majority equity holding and India's leading industrialists with nominal equity ownership **to finance modern and relatively large private corporate enterprises**.
        - ICICI Bank limited was established in 1944 and in 2002 both were merged together making it the first universal bank of India.

» In 1964, **IDBI** was set up as an apex body of all development finance institutions.

- **How were DFIs financed in India?**
    » In 1950s and 60s, the saving rate was low, and the capital market was virtually absent. So, DFIs were mostly financed by:
        1. **Lines of credit from the Reserve Bank of India** (that is, some of its profits were channelled as long-term credit); and
        2. **Statutory Liquidity Ratio bonds**, into which commercial banks had to invest a proportion of their deposits.
    » In other words, by sleight of government hand, short-term bank deposits got transformed into long-term resources for development banks. The missing capital market was made up by an administrative fiat

- **However these DFIs didn't perform well:**
    » **Faced very high NPAs** -> due to politically motivated lending and inadequate professionalism in assessing the project.
    » Therefore, after 1991, following the Narsimhan Committee recommendations on financial sector reforms, **the DFIs were disbanded and got converted into commercial banks**.

- **Result of disbanding these institutions**
    » **Steep fall in long term credit** from a tenure of 10-15 years to five years. This has contributed to **NPA crisis** of Indian PSBs.
    » Further, the development of debt market has failed to take off.

- **In China**, these developmental banks - the Agricultural Development Bank of China, China Development Bank, and the Export-Import Bank of China - have been at the forefront of financing its industrial prowess.
- **Advantages of DFIs**
    » **Fill the gap in infra financing and long-term financing:** The commercial banks have been reluctant to provide long term loans for infra projects especially after the huge NPA crisis
    » **Reducing future NPA burden on Banks**
    » **Utilize today's developmental capital and stock markets more efficiently** through specialized activities.
- Therefore, Finance Minister **Nirmala Sitharaman** while presenting the Union Budget 2021-22 stated that, India's Infrastructure needs long term financing and informed that India will set up a new **DFI** called the **National Bank for Financing Infrastructure and Development** (NABFID)

1) DETAILS ABOUT NATIONAL BANK FOR FINANCING INFRASTRUCTURE AND DEVELOPMENT (NBFID)

- NBFID Bill, 2021 was passed in Parliament in 2021.

- It was operationalized in Q1FY23.
- NBFID will be set up as a **corporate body with authorised share capital of one lakh crore rupees**.
    - Shares of NBFID may be held by: (i) central government, (ii) multilateral institutions, (iii) sovereign wealth funds, (iv) pension funds, (v) insurers, (vi) financial institutions, (vii) banks, and (viii) any other institution prescribed by the central government.
    - Initially, the central government will own 100% shares of the institution which may subsequently be reduced up to 26%.

- **Functions:**
    - » It will have both financial and developmental objectives.
    - » **Financial Objective** will be to directly or indirectly lend, invest, or attract investment for infrastructure projects located entirely or partly in India. Central government will prescribe the sectors to be covered under the infrastructure domain.
    - » **Developmental Objectives** include facilitating the development of the market for bonds, loans, and derivatives for infrastructure financing.
    - » **Functions of NBFID include**:
        - i. extending loans and advances for infrastructure projects,
        - ii. taking over or refinancing such existing loans,
        - iii. attracting investment from private sector investors and institutional investors for infrastructure projects,
        - iv. organising and facilitating foreign participation in infrastructure projects,
        - v. facilitating negotiations with various government authorities for dispute resolution in the field of infrastructure financing, and
        - vi. providing consultancy services in infrastructure financing

- **Sources of Funds**:
    - NBFID will raise money in the form of loans or otherwise both in Indian Rupee and Foreign Currency, or secure money by the issue and sale of various financial instruments including bonds and debentures.

- It will borrow money from: (i) Central Government (ii) Reserve Bank of India (iii) Schedule Commercial Banks (iv) Mutual Funds, and multilateral institutions such as WB and ADB.

- **Management of NBFID**:
    - It will be governed by **Board of Directors**. The members of Board include:
        - i. Chairperson appointed by the Central Government in consultation with RBI
        - ii. Managing Director
        - iii. Up to three deputy managing directors
        - iv. Two directors nominated by Central Government

v. A few independent directors

- **Support from central government**:
    - **Government** will provide a grant of Rs 5,000 crores to NBFID.
    - It will also provide guarantee at a concessional rate of upto 0.1% for borrowing from multilateral institutions, sovereign wealth funds, and other foreign funds.
    - Upon request from NBFID, the government may guarantee the bonds, debentures, and loans issued by NBFID.

- **Other DFIs**:
    - The Act also provides for any person to set up a DFI by applying to RBI. RBI may grant a license for DFI in consultation with the central government. RBI will also prescribe regulations for these DFIs.

- **How is NaBFID doing?**
    - As of 2023, entire shareholding of the institutions held by Central Government, which has invested equity of Rs 20,000 crore and provided a grant of Rs 5,000 crores.
    - **NaBFID** has raised Rs 10,000 crores via maiden issuance of listed bonds of 10 year duration at a coupon rate of 7.43%. It was oversubscribed by 4.7 times. (June 2023)
    - In less than a year of operation, the institution has sanctioned **25,000 crore** rupees loan. The aim is to reach Rs 1 lakh crore in terms of sanctioned amount by FY24. (July 2023)
    - It is also moving very cautiously with a **balanced portfolio** of completed projects (refinancing route), brownfield expansion and greenfield projects as a lopsided focus on green field carry high risks.
    - It is also exploring a larger role in the infrastructure segment and not in just financing, with the objective of playing a catalysing role in developing infrastructure and the entire ecosystem. For e.g. it is looking at a project advisory role in railways and transportation infra projects that are stuck, or that haven't moved at required pace.

7. INSOLVENCY AND BANKRUPTCY CODE (IBC)

- **Basic Definitions**
    - » **Insolvency** refers to a situation where individual, entity or a company is unable to meet its financial obligations (i.e. unable to pay off debts)
    - » **Bankruptcy** is the legal declaration of one's inability to pay off debts. When bankruptcy is filed, two ways of resolving insolvency is available.
        1. **Reorganization:** debtor restructure their repayment plans to make them more easily met.
        2. **Liquidation:** Debtors assets are sold to pay the creditors.

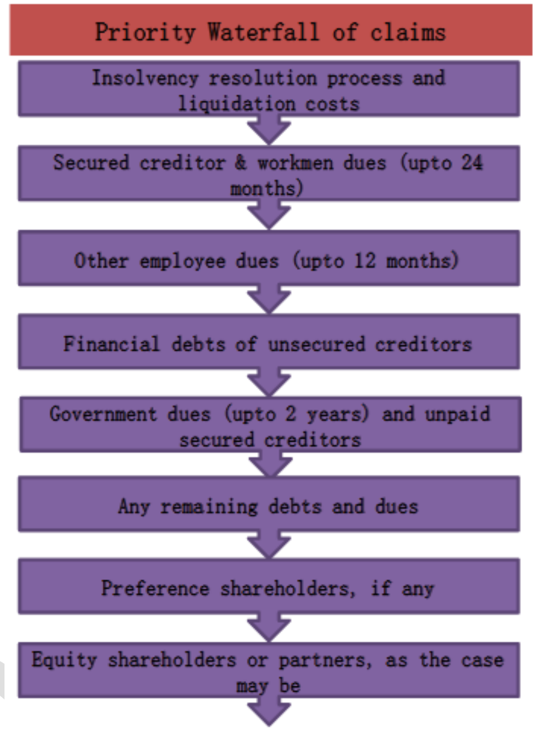
- **Problems with India's Insolvency and Bankruptcy Process (Before IBC, 2016)/Need of IBC**
    - » **Delayed Process** (9 years, (1.7 years in OECD))
    - » **High Cost of Process** (9% of total asset cost, (5% in OECD)) .

- » **Poor Recovery** (25.7% (72% in OECD))
- » **Archaic laws,** some more than 100 years old, governed the Insolvency and Bankruptcy procedures.
- » **Different acts for different entities created confusions.**
  - ▫ The **RDDB act, 1993 (Recovery of Debts due to Banks and Financial Institutions Act, 1993) and the SARFAESI Act, 2002** (**Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest ACT, 2002)** act applied only to Indian Banks and specific NBFCs which deal with housing loans.
  - ▫ **SICA** (Sick Industrial Companies Act, 1985) applied to only Industrial companies which created a major problem as India is increasingly becoming a services-led economy.
  - ▫ **Joint Lenders Forum and Corporate Debt Restructuring** also apply to only regulated banks and NBFCs. They too don't address insolvency in systematic manner.
- » **Creditors were relatively powerless** when faced with a default while promoters were, in the words of former RBI governor Raghuram Rajan, able to "insist on their divine right to stay in control".

- **Insolvency and Bankruptcy Code 2016 - passed by Parliament in May 2016**
  - » IBC 2016 is considered one of the landmark economic reforms by the Modi Government. It is based on the recommendations of **the Bankruptcy Law Reform Committee** headed by **TK Viswanathan.**
  - » **Ministry:**
    - ▫ IBC was spearheaded in Parliament by Ministry of Finance.
    - ▫ However, the administration of the IBC, 2016 has been transferred to the Ministry of Corporate Affairs from July 2016
- ▪ **Objectives**:
  - ▪ **Maximize the value of debtor's** asset
  - ▪ **Promote and encourage entrepreneurship**
  - ▪ Ensure **timely and effective resolution of IBC case**s
  - ▪ **Balance the interest of all stakeholders** including creditors, debtors and staff
  - ▪ Facilitate the promotion of a competitive market and economy
  - ▪ Provide for a framework to deal with cross border insolvency

- **Provisions:**
  - i. **Unified Framework: Applicable to both Individuals and companies**
  - ii. **Clear Coherent and Speedy Process**
    - » Code lays down a clear, coherent and speedy process for early identification of financial distress and revival of the companies and limited liability entities if the underlying business is found to be viable.
    - » **Corporate debtors (LLPs and companies):**
      - ▫ **Corporate Insolvency Resolution Process (CIRP)**:
        - ▪ Under this steps are taken for revival, selling the company to a suitable buyer, etc.
        - ▪ Resolution plan has to be approved by CoC (at least 66% of the creditors in CoC).

- **Time Bound Resolution:** Insolvency resolution - Max (~~180 + 90 Days~~) **330 days** (including the liquidation process) (after the Aug 2019 Amendment)
    - **Liquidation** - if the insolvency resolution fails. (Note: through the SC Judgment in the Essar Steel case, the 330 day deadline is no more mandatory).
- **Came into force** on 1st Dec 2016).



iii. It offers a paradigm shift from the existing **'Debtor in possession' to a 'Creditor in control' regime**.

iv. **Institutional Infrastructure for Insolvency and Bankruptcy Process under IBC**
- **Insolvency and Bankruptcy Board of India ->** Insolvency regulator, oversees the functioning of insolvency intermediaries (IPs, IPAs, IUs)
- **Insolvency Professionals and Insolvency Professional Agencies** -> private bodies -> specialized in helping sick companies -> license from IBBI required
- **Information Utilities**
    - Collate all information about debtors to prevent serial defaulters from misusing the system.
- **Adjudication** (Corporates: NCLT->NCLAT->SC; Individuals: DRT -> DRAT -> SC)

v. **Insolvency and Bankruptcy** fund
- For establishment and use by Insolvency and Bankruptcy Board of India and also for implementing various provisions of the act.

vi. **Provisions to address cross border insolvency** through bilateral agreements with other countries.

vii. **Protection of worker's interest**
- The code has provision to ensure that the money due to workers and employees from the provident fund, the pension fund and the gratuity fund shouldn't be included in the estate of the bankrupt company or individual.
- Further, worker's salaries for upto 24 months will get first priority in case of liquidation of assets of a company, ahead of secured creditors.
- It also enables workers to initiate the insolvency process and they will be first in line to get the proceeds of liquidations.

viii. **Disqualification of bankrupt from holding public office**

- **During COVID-19 pandemic**, the Insolvency and Bankruptcy (Amendment) Ordinance, 2020 was promulgated, which suspended initiation of CIRP of a corporate debtor (CD) for any default arising on or after **25th March 2020**. This suspension of code was extended twice for 3 months each on 24th Sep 2020 and 22nd Dec 2020.

- **Current Situation**:
  - As per the Financial Stability Report (FSR) released by the RBI on 28th Dec 2023:
    - Since the inception of the IBC, a total of **2,808 Corporate Debtors (CDs) have been rescued** (808 through RPs, 1053 through appeal and review settlements, 947 through withdrawals) and **2249 CDs have been referred for liquidation till Sep 2023**. As many as 2,001 are pending (36 for seven years and 502 for six years)

- **Significance/Key Achievements of IBC:**
  - IBC has created a **cohesive and comprehensive insolvency ecosystem**.
  - It has **made it easy for creditors** to deal with default.
  - It has **professionalized insolvency services** by creation of two professions namely: the insolvency profession and the valuation profession
  - It has **fast tracked** the insolvency and bankruptcy process and has resulted into **higher recovery** and thus has benefitted all the creditors including banks. As per ESI 2021-22:
    - In value terms **74%** of distressed assets were rescued.
    - The average time for resolution (428 days) and liquidation (375 days) is a reduction over the pre-IBC times.
  - IBC has also ensured **fast track closing of businesses** enhancing a key component in India's Ease of Doing Business.
  - **IBC** has also led to **Behavioural change**.
    - **Increased responsibility and accountability** have been ensured among borrowers. This has ensured that business entities are paying upfront before being declared insolvent.
    - Further, in case of distress, thousands of debtors are resolving distress in the early stage of distress.
- **Concerns:**
  - **Little Realizable Value**: RBI's Financial Stability report in Dec 2023 mentions little realizable value to the creditors (16.9% in 2020-21; 22.4% in 2021-22; and 37.1% in 2022-23).
    - Also, according to the 32nd report on **Parliamentary Standing Committee on Finance**, submitted to Parliament on Aug 3, 2021: the **recovery rates are low** upto 5% with haircuts as much as **95%**.
  - **Numerous issues with Resolution Professionals (RPs)** for which regulators IPA and IBBI have taken disciplinary action on 123 Insolvency Professionals (IPs) out of 203 inspections conducted till date (i.e. **around 60% of IPs** inspected were found to be indulging in malpractices).
  - **Capacity of NCLT**: Large number of pending cases

1) PRE-PACKAGED INSOLVENCY RESOLUTION PROCESS (PPIRP) FOR CORPORATE MSMES

- In April 2021, GoI amended the IBC Code, 2016 to introduced PPIRP for corporate MSME with defaults up to Rs 1 crore.
- **Key Features of PPIRP**
  - **Voluntary Initiation**: It is initiated voluntarily by the debtor. The debtor and creditor mutually work on a resolution plan and approach NCLT for its approval.

» **Expedited Resolution**: PPIRP is expected to be a faster process, with a maximum timeline of 120 days for the submission and approval of the pre-packaged plan.
» It has rigour and discipline of the CIRP. At the same time, it is informal upto a point and formal thereafter.
» **Minimal Disruption**: The management of the affairs of the CD shall continue to vest in the Board of Directors/ partners of the CD and the resolution professional conducts the process under the guidance and oversight of the creditors.
» **Creditor's involvement** in the resolution plan make it more likely to be feasible and acceptable by them.
» The **informality in the beginning** (pre-initiation phase) offers **flexibility** for the CD and its creditors to swiftly explore and negotiate the best way to resolve stress in the business.
» The **post-initiation stage drives value maximization** and bestows the resolution plan with statutory protection.

- **Advantages:**
  » Time efficient resolution
  » Early revival of stressed assets
  » Improved business continuity
  » Enhanced stakeholder involvement
  » Reduction in cost in insolvency resolution process
  » Preserve asset value: Early resolution can help preserve the value of the debtor's assets, preventing further deterioration and maximizing creditor's recovery.

2) CROSS BORDER INSOLVENCY (INTERNATIONAL INSOLVENCY) LAW IN INDIA

- **Intro**
  » Cross border Insolvency mechanisms deals with financially distressed debtors who have assets or creditors in more than one country. Currently, the Cross Border Insolvency has no clear legal framework in India.

- **Why cross border insolvency process is important?**
  » **Increasing global footprint of corporates**
  » **Improving Ease of Doing Business**
  » **Preventing the misuse of bankruptcy law**: It will further help India in dealing with cases like that of Nirav Modi who has filed for Bankruptcy in USA.

- **Key components of Cross border insolvency:**
  i. Which **law** is applicable in case of cross border insolvency
  ii. Who has the **jurisdiction** to administer the insolvency process.
  iii. How are judgments asserting control on assets **enforced**.

A) THE UN COMMISSION ON INTERNATIONAL TRADE LAW (UNCITRAL) MODEL LAW

- This is a model law issued by UNCITRAL in 1997, to assist countries in regulating cross border insolvency. Over the years it has emerged as the most widely accepted legal framework to deal with cross-border insolvency issues.

- It is based on the principle of **Modified Universalism** (as opposed to Territorialism and Universalism).
- The law addresses the core issues of cross border insolvency cases with the help of **four main principles:**
  i. **Access**: It allows foreign professionals and creditors direct access to domestic courts and enables them to participate in and commence domestic insolvency proceedings against a debtor
  ii. **Recognition**: It allows **recognition of foreign proceedings** and enables courts to determine relief accordingly.
  iii. **Cooperation**: It provides a framework for cooperation between insolvency professionals and court of countries.
  iv. **Coordination**: It allows for coordination in the conduct of concurrent proceedings in different jurisdiction.
  v. **Main Proceeding:** Principle for identifying where the insolvency proceeding (the main proceeding) should be initiated?
     - The law sets out the **Centre of Main Interests (COMI)** in deciding where the main proceedings should be commenced.
       - The law doesn't define COMI, but it is generally presumed to be debtor's registered office or location of its assets and its significant operations.
- **How many countries have adopted UNCITRAL?**
  - As of Oct 2023,**around** states have adopted the UNCITRAL Model Law (including USA, UK and Singapore). Some of them have set a reciprocity pre-condition.
- **Other Facts for Pre**
  - UNCITRAL, established in 1966, is a subsidiary body of the General Assembly of the UN.
  - It is mandated with harmonization and unification of the international trade law, as per the website.

B) CROSS BORDER INSOLVENCY IN INDIA

- India has **not yet adopted** UNCITRAL Model Law. (as of Oct 2023)
- Earlier, Justice V. Balakrishna Eradi Committee in 2000 and N.L. Mitra Committee had recommended the adoption of the model law.
- **Under the current IBC, 2016**, two sections deal with cross border insolvency.
  - Section 234 of the code empowers government to sign treaties to enable the provisions of the code.
  - Section 235 provides for a 'letter of request' by the liquidator for action on the assets of the company situated in other country. However, a reciprocal arrangement must exist there.
- India has not yet initiated the bilateral treaty mechanism to deal with cross border insolvency provisions.

C) THE REPORT OF INSOLVENCY LAW COMMITTEE (ILC) - CHAIRED BY CORPORATE AFFAIRS SECRETARY INJETI SRINIVAS (OCT 2018)

- **Key Findings**
  - Section 234 and 235 of the IBC, don't provide a comprehensive framework on cross-border insolvency.
- **Key recommendations: Adoption of the UNCITRAL Model Law** as it provides a comprehensive framework to deal with cross border insolvency issues.
  - **Some changes to ensure consistency with IBC:** India's adoption of model law should only include corporate debtors and not individuals.

3) BAD BANK: NATIONAL ASSET RECONSTRUCTION COMPANY LTD (NARCL) AND INDIA DEBT MANAGEMENT AGENCY (IDMA) – CLASS DISCUSSION

8. CREDIT RATING AND ASSOCIATED ISSUES

- **Intro**
  - » **Credit Rating** measures the ability of a person or organization to fulfill their financial commitments, based on previous dealings. It is the quantified assessment of the **creditworthiness** of a borrower in general terms or with respect to a particular debt or financial obligation.
    - ▫ A credit rating can be applied to any entity that seeks to borrow money - an individual, corporation, state or provincial authority, or sovereign government.

- **Credit Rating Agencies**
  - » A CRA is a **company that assigns credit ratings**, which rate a debtor's ability to pay back debt by making timely principal and interest payments and the likelihood of default.

- **Significance of Credit Ratings:**
  - » **Investor Guidance and protection**: Information which can help choose good investments.
  - » **CRAs help in strengthening of secondary market** and hence enhance investments and increase borrower pool.
  - » These ratings also bring **discipline amongst corporate borrowers** as they all want to have good ratings for their good image.
  - » **CRAs build trust between citizens and governments** by quantifying the risk associated with making investment in a country.
  - » Credit ratings **ensures precautionary measures** to be taken to prevent long term troubles.

- **Big Three Credit Rating Agencies**
  1. Moody's (headquartered in New York): It is the oldest of the CRAs and was established in 1900 and issued its first sovereign ratings just before WW-1.
  2. Standard and Poor's (S&P) (headquartered in New York): In the 1920s, Poor's Publishing and Standard Statistics (the predecessor of S&P), started rating government bonds.
  3. Fitch Group (dual headquartered in New York and London)

- **Domestic Rating Agencies**
  1. **CRISIL**
     - CRISIL (formerly Credit Rating Information Services of India Limited) is a global analytical company providing ratings, research and risk and policy advisory services.
     - CRISIL's majority shareholder is Standard's and Poor, a division of McGraw Hill Financial and provider of financial market intelligence.
  2. **ICRA Limited**

- It is an Indian independent and professional investment information and credit rating agency and was established in 1991 and was originally named Investment Information and Credit Rating Agency of India Limited (IICRA).
- It is a joint venture between **Moody's and various Indian Commercial banks**. The company went public in 2007 with a listing on BSE and NSE and also changed its name to ICRA.

3. **CARE** ratings.
    - It is the second largest credit rating agency in India. It started in 1993.
    - To enhance its scope of business CARE rating has been nurturing global opportunities and made forays in different forms: launched a new international credit rating agency 'ARC Ratings' with 4 partners from Brazil, Portugal, Malaysia and South Africa.
4. **India Ratings and Research (Ind-Ra)** is 100% owned by the Fitch Group.
5. **Other Important domestic credit rating agencies**
6. FITCH India, Brickwork Ratings and SMERA

- **Regulation of Credit Rating Agencies in India**
    - An efficient and simple regulatory mechanism for CRAs is required to protect investors and make the system more helpful for them.
    - **SEBI is the lead regulator** of CRAs in India. The **Securities and Exchange Board of India** (**Credit Rating Agencies) Regulations,** 1999 **empowers SEBI to do this.**
        - In the CRA regulations, the SEBI has prescribed a **code of conduct** to be followed by the rating agencies in the CRA regulations.
        - SEBI provides a **disclosure-based regulatory regime**, where the agencies are required to disclose their rating criteria, methodology, default recognition policy, and guidelines for dealing with conflict of interest.
    - But SEBI regulates the functioning of CRAs with respect to their functioning in securities market only.
    - **In addition to SEBI, RBI, IRDA and PFRDA** are also involved in the regulation of the CRAs.

- **Sovereign Credit Ratings:**
    - Sovereign Credit Ratings are about the creditworthiness of governments. They provide marker for investors around the world about the ability and willingness of governments to pay back debt. It affects the ability to borrow money from global investors. Governments with good ratings can get cheaper loans and vice versa.
    - Sovereign ratings also impact businesses in the country. If government has low credit ratings, the businesses also end up paying higher interest rates to global creditors.

- **Global Credit Rating Agencies and Major criticisms by GoI**
    - **Criticisms by GoI:**
        - In Dec 2023, finance ministry released a document titled **Re-examining Narratives**: A collection of Essays. The first of the five essays seeks to **flag issues with the methodology adopted by the three main CRAs**, and to show, based on calculations by Finance Ministry, how these gaps affect India adversely.
        - The first of the five essays in the document is a criticism of what the government calls the "opaque methodologies adopted by CRAs to arrive at sovereign ratings".
        - **Three main criticisms of the rating agencies by GOI**:

- They are **opaque** and appear to disadvantage developing economies.
  - For e.g. a situation of public owned banks is considered negative. But this discriminates against developing countries which mostly have banks in public sector.
- The experts generally consulted for the rating assessments are selected in a non-transparent manner, adding another layer of opaqueness to an already difficult-to-interpret methodology.
- The rating agencies don't clearly convey the assigned weights for each parameter considered. "While Fitch does lay out some numerical weights for each parameter, they do go on to state that the weights are for illustrative purposes only".
  - For e.g. Fitch uses four main pillars such as macroeconomic outlook, structural features etc. Each pillar is further divided into sub-components with sub-weights. But apart from quantitative variables, there is also a "Qualitative overlay" variable which adds to subjectivity.
    - The use of **Composite Government Indicator** (as a sub-component under Structural Features) is only based on World Bank's Worldwide Governance Indicator (WGI). The WGI uses a host of indices and reports such as WEF's Global Competitiveness Report, Economic Intelligence Unit, etc. to assess several aspects of a country that **may not capture hard economic data**. These include freedom of expression, freedom of media, rule of law, corruption etc. The government of India says that there is an **excessive reliance on such subjective appraisals**.
    - And the use of Qualitative overlay implies a subjective assessment.
  - Because of all this, to earn a credit upgrade, developing economies need to demonstrate progress along a set of several one-size fits all perception-based surveys.

- **Other criticisms**:
  - The three global credit rating agencies constitute a cartel and US companies often received superior ratings.

9. NEXT BOOKLET

Nationalization, Consolidation of Banks, Privatization of PSBs, types of banks, NFBCs, Fintech, Pension sector