MONETARY MANAGEMENT AND FINANCIAL INTERMEDIATION: STABILITY IS THE WATCHWORD

02

CHAPTER

India's banking and financial sectors have displayed a stellar performance in FY24. Double-digit and broad-based growth in bank credit, gross and net non-performing assets at multi-year lows, and improvement in bank asset quality highlight the government's commitment to a healthy and stable banking sector. Capital markets are becoming prominent in India's growth story, with an expanding share in capital formation and investment landscape on the back of technology, innovation, and digitisation. Indian stock market was among the best-performing markets, with India's Nifty 50 index ascending by 26.8 per cent during FY24, as against (-)8.2 per cent during FY23. The market capitalisation of the Indian stock market has seen a remarkable surge, with the market capitalisation to GDP ratio being the fifth largest in the World. Supported by regulatory measures and the vision to achieve 'Insurance for all by 2047', India is poised to emerge as one of the fastest-growing insurance markets over the next five years. The pension sector witnessed a robust increase in subscribers and assets under management.

While the outlook for India's financial sector appears bright, some areas will require focused attention going forward. The significant increase in retail investors in the stock market calls for careful consideration. This is crucial because the possibility of overconfidence leading to speculation and the expectation of even greater returns, which might not align with the real market conditions, is a serious concern. For a developing economy such as India, the financial sector needs to support the banking sector and fill the gap in capital required for the economy's growth. Therefore, the financial sector should expand at a pace that is in lockstep with economic growth. In particular, India can ill-afford the economy's over financialisation at its current development stage.

The increased retail participation in financial markets and familiarity with financial products are beginning to grow in line with India's emergence as the world's fifth-largest economy. Therefore, firms operating in banking, insurance, and capital markets must keep the interests of the consumers in mind and improve their service quality through fair selling, disclosure, transparency, reliability, and responsiveness. Their internal appraisal and incentive systems must be in alignment with these considerations. It is in their interest and in the interest of the nation that they optimise their commercial goals over the long run.

INTRODUCTION

2.1 The Indian economy's financial and banking sectors have shown strong performance despite continuous geopolitical challenges. The Central Bank maintained a steady policy rate throughout the year, with the overall inflation rate under control. The effects of the monetary tightening following the Russia-Ukraine conflict are evident in the lending and deposit interest rates increase among banks. Bank loans saw significant and widespread growth across various sectors, with personal loans and services leading the way.

2.2 Capital markets have also shown impressive results, with India's stock market capitalisation to GDP ratio ranking fifth globally.[1] The presence of a robust Digital Public Infrastructure (DPI) and the greater involvement of banks and microfinance institutions (MFIs) have contributed to improved financial inclusion. The insurance and pension sectors are also doing well, as indicated by their expanding coverage.

2.3 Against this backdrop, the chapter is divided into two parts-Monetary developments and financial intermediation. The monetary developments part presents the monetary and liquidity conditions of the economy.

2.4 The financial intermediation part offers a discussion on the state of various financial institutions and financial market instruments that form part of the financial market milieu in India. Section I of this part presents the performance of the country's banking sector, which is the most critical pillar of the financial intermediation landscape. Section II highlights the Government’s mechanism for dealing with distressed assets and how the Insolvency and Bankruptcy Code, 2016 (IBC/Code) has emerged as a game-changer in resolving insolvencies. Section III discusses the Government’s approach towards financial inclusion with increased emphasis on digital financial inclusion and data protection. Section IV highlights the role of MFIs in facilitating financial inclusion and promoting inclusive growth. Section V discusses the securities markets, which have come a long way to become an alternative and efficient means of resource mobilisation for the corporate sector and the Government. The global stature of India’s securities markets in using technology and best practices in regulations is a matter of pride. Section VI concerns the International Financial Services Centre, Gujarat International Finance Tec-City (IFSC GIFT City) and how it is emerging as a global financial and IT service hub. Sections VII and VIII present the developments in the insurance and pension sectors. Section IX discusses the government’s mechanism to ensure regulatory coordination and overall financial stability, highlighting the role of the Financial Stability and Development Council (FSDC). Section X provides an overall conclusion and the outlook for the financial sector while mentioning the key challenges to tackle going forward.

[1] As per the World Federation of Exchanges (WFE)

MONETARY DEVELOPMENTS

2.5 Monetary policy plays a crucial role in determining the economic conditions of a country through its influence on macroeconomic indicators such as economic growth, inflation, and investments. The primary objective of monetary policy is to maintain price stability while keeping in mind the objective of growth. Various instruments of monetary policy, viz. cash reserve ratio (CRR) and statutory liquidity ratio (SLR) of banks, open market operations of the Central Bank, and imposition of credit ceilings, etc., are used by the central bank in the direction of this overall objective. This section of the chapter presents the recent monetary developments in the economy, focussing on the emerging liquidity conditions and monetary policy transmission in terms of lending and deposit rates of banks.

Monetary and Credit Conditions

2.6 Monetary and credit conditions evolved in line with the monetary policy stance during the year, supporting domestic economic activity. The Monetary Policy Committee (MPC) maintained the status quo on the policy repo rate at 6.5 per cent in FY24. It focused on withdrawing accommodation to ensure that inflation gradually aligns with the target while supporting growth. With the cumulative policy repo rate hike of 250 basis points (bps), undertaken between May 2022 and February 2023, working its way through the economy, the MPC kept the policy repo rate unchanged at 6.5 per cent since February 2023, but with readiness to undertake appropriate and timely policy actions if the situation so warrants.

2.7 Important factors impacting the evolution of monetary and credit conditions during FY24 were the withdrawal of ₹2,000 banknotes (May 2023)[2], the merger of HDFC, a non-bank with HDFC Bank (July 2023), and the temporary imposition of the incremental CRR (I-CRR) (August 2023). The expansion in reserve money and currency in circulation (CiC) moderated due to the return of a predominant part of ₹2,000 banknotes to the banking system as deposits. As per the Reserve Bank of India (RBI), the total value of ₹2,000 banknotes in circulation has declined from ₹3.56 lakh crore as of 19 May 2023 (when the withdrawal of ₹2,000 banknotes was announced) to ₹7,581 crore as of 28 June 2024, indicating that 97.87 per cent of the ₹2,000 denomination banknotes have returned to the banking system.[3] This and an increase in term deposit rates contributed to an acceleration in aggregate deposits and broad money (M3). The growth in CiC moderated to 4.1 per cent from 7.8 per cent YoY in the last year, reflecting the impact of the withdrawal of ₹2,000 banknotes.

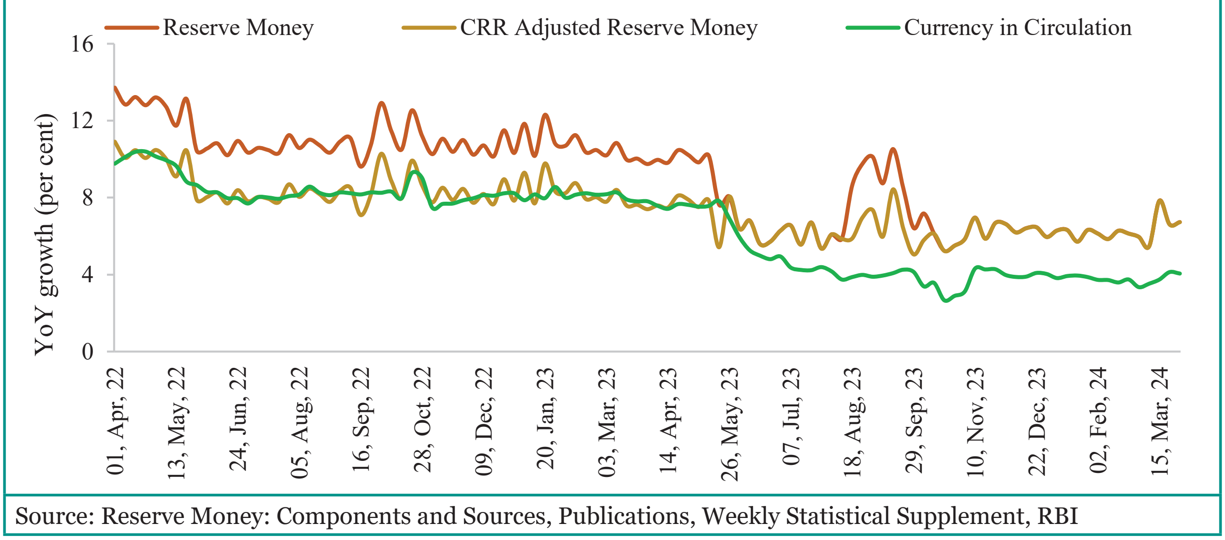
2.8 Reserve Money (M0) recorded a year-on-year (YoY) growth of 6.7 per cent as of 29 March 2024, compared to 9.7 per cent in the previous year. M0, adjusted for the first-round impact of

[2] Vide circular dated 19 May 2023 https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=55707, RBI announced the withdrawal of ₹2000 banknotes from circulation since (i) about 89% of the ₹2000 denomination banknotes were issued before March 2017 and are at the end of their estimated life-span of 4-5 years; (ii) the total value of these banknotes in circulation has declined from ₹6.7 lakh crore at its peak as of 31 March 2018 (37.3% of Notes in Circulation) to ₹3.62 lakh crore, constituting only 10.8% of notes in Circulation as of 31 March 2023; (iii) this denomination is not commonly used for transactions, and (iv) the stock of banknotes in other denominations continues to be adequate to meet the currency requirement of the public.

[3] RBI press release dated 1 July 2024, 'Withdrawal of ₹2000 Denomination Banknotes – Status', https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=58199

changes in the CRR, recorded a 6.7 per cent growth compared with 7.4 per cent a year ago. The increase in M0 was mainly driven by net foreign assets (NFA) during FY24.

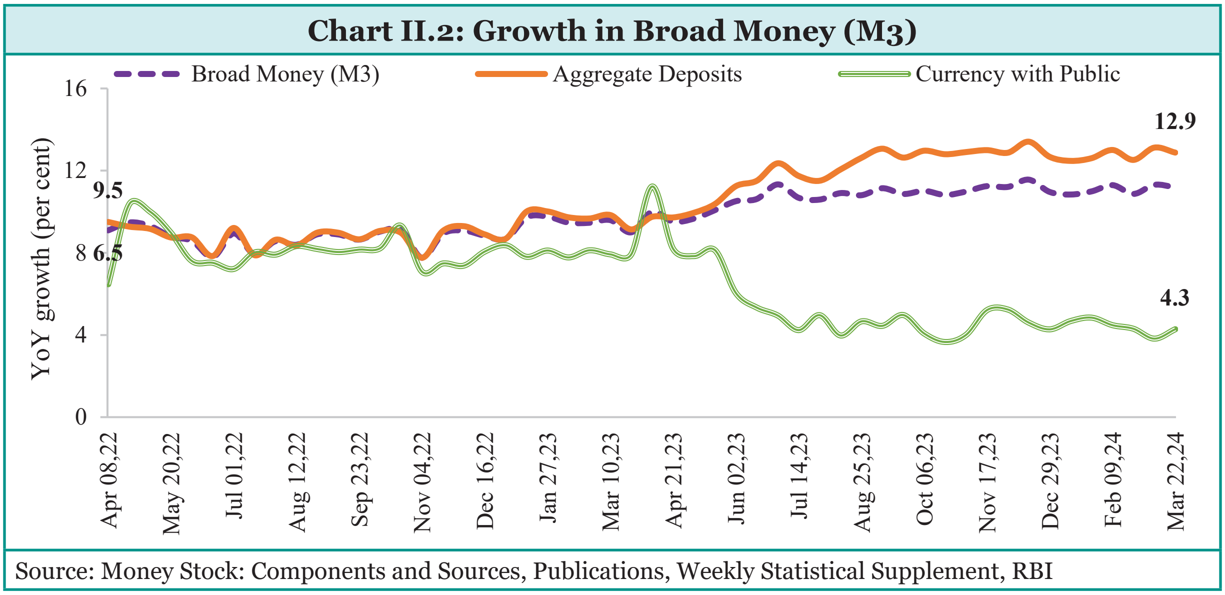
Chart II.1: Moderation in growth in Reserve Money (M0)



Source: Reserve Money: Components and Sources, Publications, Weekly Statistical Supplement, RBI

2.9 The growth in Broad Money (M3), excluding the impact of the merger of HDFC with HDFC Bank (with effect from 1 July 2023), was 11.2 per cent (YoY) as of 22 March 2024, compared to 9 per cent a year ago. On the components side[4], aggregate deposits (AD), the most significant component, contributed most to the expansion of M3. Amongst sources, bank credit to the commercial sector significantly contributed to the increase in M3, with a share of 67.1 per cent as of 22 March 2024, supplemented by net bank credit to the Government. (share of 29.4 per cent)[5]

Chart II.2: Growth in Broad Money (M3)

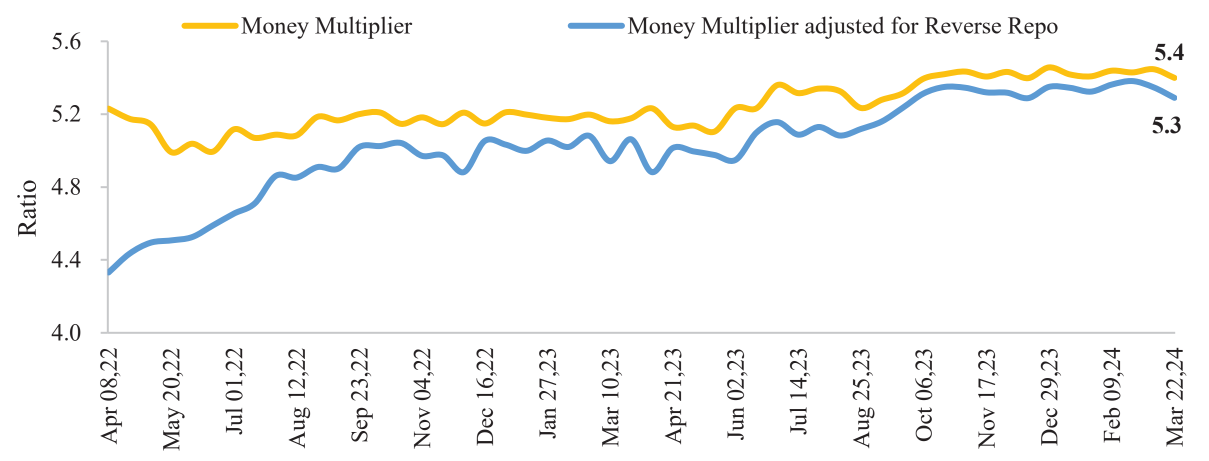


Source: Money Stock: Components and Sources, Publications, Weekly Statistical Supplement, RBI

[4] Components of Broad Money=Currency with the Public + Aggregate Deposits (Demand Deposits with Banks + Time Deposits with banks + 'Other' deposits with Reserve Bank)

[5] Sources of Broad Money=Net Bank Credit to Government + Bank Credit to Commercial Sector + Net Foreign Exchange Assets of Banking Sector + Government's Currency Liabilities to the Public- Banking Sector's Net Non-Monetary Liabilities)

Chart II.3: Higher Money Multiplier in FY24, indicating higher liquidity in the market



Source: Money Stock: Components and Sources, Publications, Weekly Statistical Supplement, RBI
Reserve Money: Components and Sources, Publications, Weekly Statistical Supplement, RBI

2.10 As of 22 March 2024, the Money Multiplier (MM) was 5.4 against 5.2 a year ago. Adjusted for reverse repo amounts, analytically akin to banks' deposits with the Central Bank, the adjusted MM was marginally lower at 5.3 as of March 2024.[6]

Liquidity conditions and trends in policy rates

2.11 The RBI's liquidity management involved two-way operations in response to shifts in liquidity conditions. During FY24, 17 fortnightly Variable Rate Reverse Repo (VRRR) auctions and seven Variable Rate Repo (VRR) auctions were undertaken as the primary operation. In addition, 49 fine-tuning operations (25 VRRR and 24 VRR) were conducted intermittently, modulating liquidity conditions in alignment with the monetary policy stance. Amidst tightened liquidity conditions, banks also took recourse to the marginal standing facility (MSF). Given the extensive deployment of surplus funds under the standing deposit facility (SDF) and simultaneous recourse to the MSF, reversal of liquidity facilities under both the SDF and the MSF was allowed even during weekends and holidays, effective 30 December 2023.[7]

2.12 Taking cognisance of risks that excess liquidity can pose to price and financial stability and the increase in the surplus liquidity, inter-alia, due to the return of ₹2,000 banknotes to the banking system, the RBI announced a temporary I-CRR of 10 per cent on 10 August 2023[8]. The I-CRR, which impounded about ₹1.1 lakh crore from the banking system, was reviewed on 8 September 2023 and discontinued in a phased manner, ending 7 October 2023. The impounded amount was thus released to the banking system ahead of the festival season in line with the announcement on the Developmental and Regulatory Policies of 10 August 2023. As a result of these actions, the banking system's liquidity moderated, becoming a deficit in mid-September, which persisted during FY24.

[6] Money Multiplier (MM) refers to the amount of M3 a bank generates with each rupee of M0 available to them. It depicts the relationship between the monetary base and the economy's money supply, indicating how fast the money supply will grow from the bank's lending activity. Higher the value of the MM, the higher the liquidity in the market and vice versa.

[7] This measure will be reviewed after six months or earlier if needed.

[8] RBI Governor's Statement: 10 August 2023, para 18, https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=56175

Moderation in liquidity conditions

Chart II.4a: Liquidity conditions

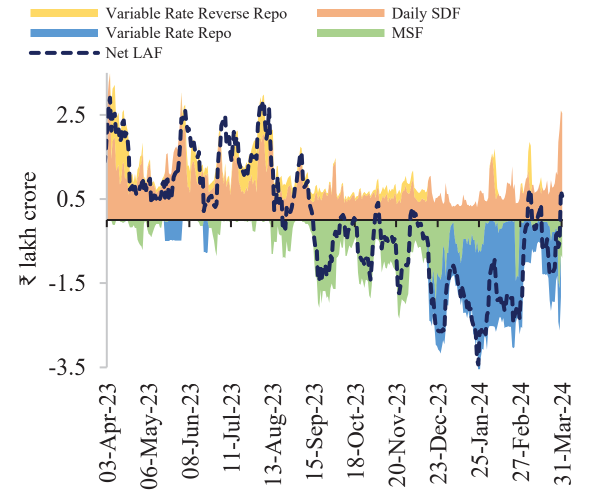
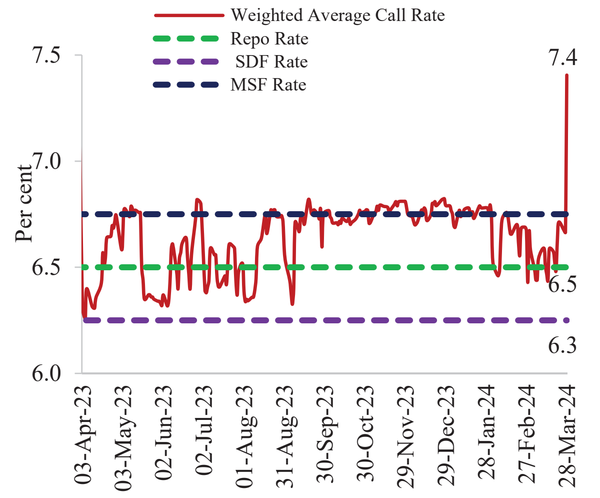


Chart II.4b: Policy corridor and overnight call money rate



Source: Liquidity Operations by RBI, Publications, Weekly Statistical Supplements

Monetary policy transmission

2.13 Lending and deposit rates of scheduled commercial banks (SCBs) increased further during FY24, reflecting the lagged impact of the policy rate hikes during May 2022-February 2023, the external benchmark-based lending rate system of loan pricing and the moderation of surplus liquidity. During the current tightening cycle, i.e., from May 2022 to May 2024, the external benchmark-based lending rate and the one-year median marginal-cost-of-funds-based lending rate increased by 250 bps and 175 bps, respectively. The transmission of hike in policy rates to lending and deposit rates is given in Table II.1.

Table II.1: Pick-up in transmission to domestic lending and deposit rates

	May-22 to May -24	Apr-23 to Mar-24
WALR-Outstanding Rupee Loans	1.14	0.11
WALR-Fresh Rupee Loans	1.88	0.05
WADTDR-Outstanding Rupee Deposits	1.90	0.73
WADTDR-Fresh Rupee Deposits	2.44	0.14

Source: Lending and Deposit Rates of SCBs, RBI Press Release (various issues)
Note: WALR: Weighted average lending rate
WADTDR: Weighted average domestic term deposit rate

FINANCIAL INTERMEDIATION

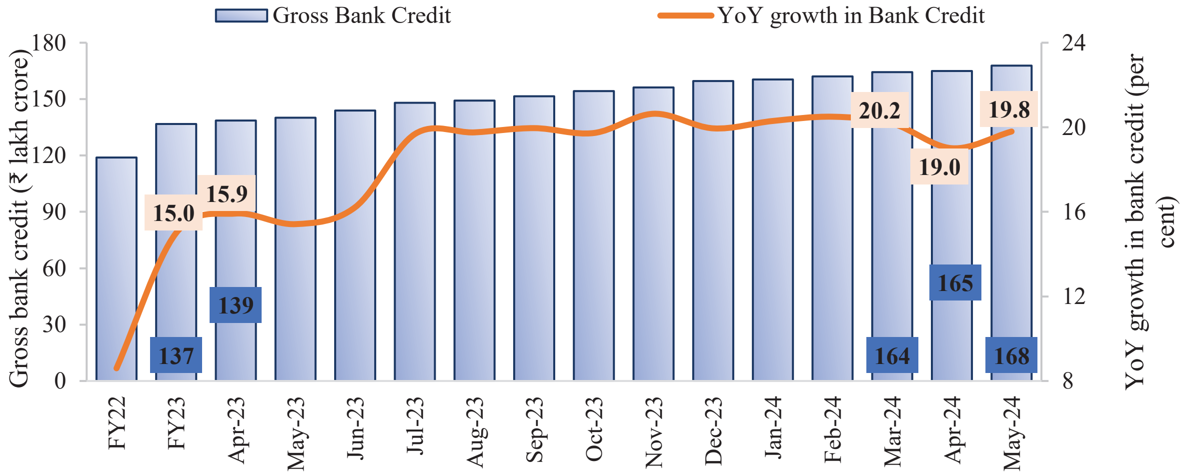
2.14 Financial development and economic growth are inextricably linked, and financial intermediation is the pathway through which the former translates into the latter. Financial intermediation helps in the efficient allocation of limited resources. Renowned economist Joseph Schumpeter believed that the services provided by financial intermediaries, viz. mobilising savings, extending credit, storing assets, growing them, managing risk, and facilitating transactions, were essential for technological innovation and economic development.[9] Financial intermediation also facilitates and encourages the inflows of foreign capital. Empirical studies[10] show that efficient and developed financial markets can lead to increased and inclusive economic growth by improving the allocation and utilisation of savings and ensuring access to finance to all sections of society, including vulnerable groups and small and medium-sized firms.

2.15 Financial development parameters should not only be sound, but they also ensure the system's financial stability as a whole. This requires indicators such as Capital to Risk (Weighted) Assets Ratio (CRAR) , liquid assets to deposits, and short-term credit to be within manageable limits. Further, an essential part of financial sector development is implementing robust policies for regulation and supervision of all the financial market entities, market players, and financial instruments. Coordinating amongst Regulators is paramount in this regard.

Performance of the banking sector and credit availability

2.16 The soundness and resilience of India's banking sector have been underpinned by ongoing improvements in asset quality, enhanced provisioning for bad loans, sustained capital adequacy, and a rise in profitability. Credit growth remains robust, mainly driven by lending to services and personal loans. As mentioned in para 2.9-2.10, deposit growth has also gained momentum due to the transmission of previous rate increases, resulting in the repricing of deposits and higher accretion to term deposits. Lending by non-banking financial companies (NBFCs) accelerated, led by personal loans and loans to the industry, and their asset quality has improved.

Chart II.5: Double-digit growth in credit disbursal by SCBs



Source: Deployment of Bank Credit by Major Sectors, Handbook of Statistics on Indian Economy, Table No. 170, RBI
Note: Data includes the impact of merger of a non-bank with a bank

[9] Schumpeter, Joseph A. The Theory of Economic Development, (Cambridge, MA: Harvard University Press, 1911).

[10] Arestis, P., & Demetriades, P. (1997). Financial development and economic growth: Assessing the evidence. The Economic Journal, 107(142), 783–799; Aziakpono, M. J. (2011). Financial development and economic growth: Theory and a survey of evidence. Studies in Economics and Econometrics, 35(1), 15–43.; Calderón, C., & Liu, L. (2003). The direction of causality between financial development and economic growth. Journal of Development Economics, 72(1), 321–334.

2.17 Bank credit growth has sustained momentum during FY24, with broad-based growth across sectors. Credit disbursal by SCBs stood at ₹164.3 lakh crore, growing by 20.2 per cent at the end of March 2024, compared to 15 per cent growth at the end of March 2023. The trend is continuing in FY25, as reflected in a 19 per cent and 19.8 per cent YoY growth in bank credit in April and May 2024.

Sectoral credit growth

2.18 Growth in credit to agriculture and allied activities was in double digits during FY24. Agricultural credit had increased nearly 1.5 times from ₹13.3 lakh crore in FY21 to ₹20.7 lakh crore in FY24. The Kisan Credit Card (KCC) scheme has played a pivotal role in providing timely and hassle-free credit to farmers, with over 7.4 crore operative KCC accounts at the end of 2023.[11] Increased credit disbursal to the agricultural sector continued in April and May 2024 with bank credit to agriculture and allied sectors growing by 19.7 per cent and 21.6 per cent YoY, respectively

2.19 Industrial credit growth picked up in H2 of FY24, registering 8.5 per cent growth in March 2024, compared to 5.2 per cent a year ago, driven by an increase in bank credit to small and large industries. The boost in credit disbursal to Micro, Small and Medium Enterprises (MSMEs) has been supported by the availability of collateral-free loans with a 100 per cent credit guarantee under the Emergency Credit Linked Guarantee Scheme (ECLGS). Further, the availability of enriched and timely credit data and rapid implementation of digital lending infrastructure have significantly contributed towards enhancing lender confidence Box II.1 discusses the measures undertaken by the Government to ensure credit availability to MSMEs and their success. In the future, the development of new technologies, such as the Open Credit Enablement Network (OCEN)[12], are expected to boost credit flow to the MSME sector.

Box II.1: Enhancing the flow of bank credit to MSMEs through formalisation

Improving credit flow to the MSME sector at low cost has been a policy priority of the Government and RBI. Various initiatives have been undertaken in this regard. These are elaborated below[13]:-

- **Introduction of Trade Receivables Discounting System (TReDS):** TReDS is a digital platform that facilitates the discounting of MSMEs' trade receivables through multiple financiers- Banks and NBFCs- to meet liquidity and working capital requirements. Cumulatively, 98.9 lakh invoices amounting to ₹2.9 lakh crore have been discounted on TReDS platforms, as of 31 March, 2024 supporting MSMEs for better liquidity and working capital management.

[11] PIB Press Release of Ministry of Finance dated 27 December 2023, https://shorturl.at/EqWwK

[12] OCEN is a decentralised open credit network that codifies the flow of credit between borrowers, lenders, and credit distributors under a common set of standards. It is expected further to strengthen the digital public infrastructure of the country

[13] This box write up is based on information/data from the Ministry of MSME and UDYAM Portal, https://www.msme.gov.in/, https://udyamregistration.gov.in/

- **Change in definition of MSMEs:** From 1 July 2020, MSMEs are defined as per a composite criterion of turnover and investment in plant and machinery/equipment. This is envisaged to bring a large number of entrepreneurs under the ambit of the formal banking sector, which will facilitate the flow of credit to the industry at subsidised rates.

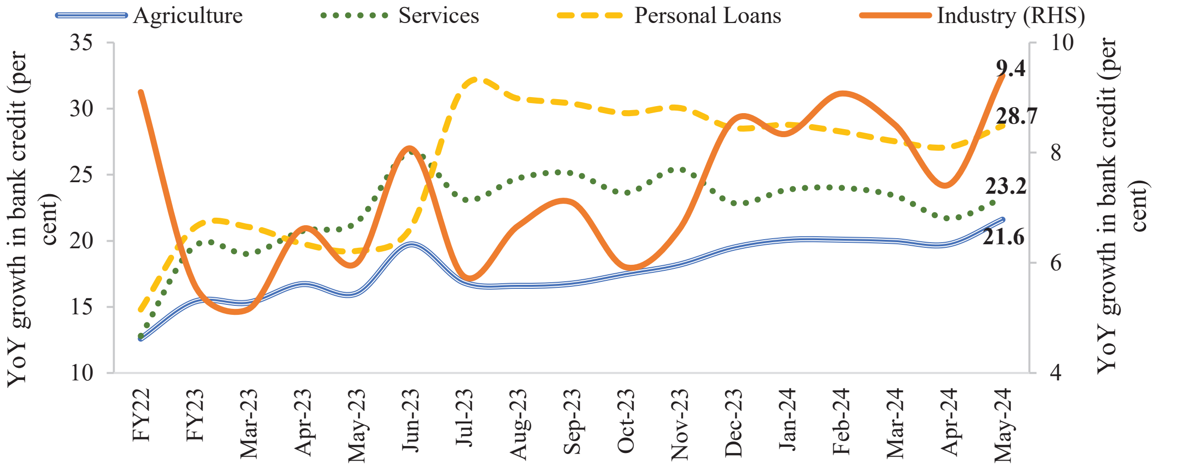
- **Registration of MSMEs on Udyam Portal:** The Ministry of MSMEs launched the Udyam Registration Portal (URP) on 1 July 2020 and since then has established itself as an essential enabler for ease of doing business, as it is free of cost, simple and online. This was done to bring entrepreneurs under the ambit of the formal banking sector, which will facilitate the flow of credit to MSMEs at subsidised rates. However, one challenge with URP is the registration of Informal Micro Enterprises (IMEs) which are sizeable in number. As per the 73rd National Sample Survey, 6.3 crore unincorporated non-agricultural entities existed in FY16, primarily micro-enterprises. Since IMEs do not have a PAN/GST, they cannot register on URP and avail themselves of the benefits of Government programmes. To formalise such enterprises, the Ministry of MSME, in collaboration with the Small Industries and Development Bank of India (SIDBI), launched the Udyam Assist Platform (UAP) on 11 January 2023. Through formalisation, informal micro enterprises will be linked to various facilities such as access to markets and credit etc. As of June 2024, 1.86 crore IMEs have been onboarded on UAP. More than 4.5 crore enterprises have been registered on URP and UAP as of 3 June 2024.

- **Revamp of Credit Guarantee Scheme (CGS) for MSEs:** In the Union Budget FY23, the revamp of the CGS for Micro and Small Enterprises (MSEs) was announced with a required infusion of funds to facilitate an additional credit of ₹2 lakh crore for MSEs. Accordingly, the CGS was revamped with an infusion of ₹9,000 crore in the corpus of Credit Guarantee Fund Trust for MSEs. Subsequently, the credit limit under the said scheme was enhanced from ₹2 crore to ₹ 5 crore, with a minimum annual guarantee fee of as low as 0.37 per cent per annum. Consequently, credit guarantees worth ₹3 lakh crore were approved during FY23 and FY24 against the target of ₹2 lakh crore in four years. During FY23, out of the guarantees of ₹1.04 lakh crore, ₹16,373 crore and ₹2,750 crore were extended to women and SC/ST-owned enterprises, respectively. Guarantees worth ₹2.02 lakh crore were extended in FY24, out of which ₹32,223 crore and ₹5,393 crore were extended to women & SC/ST-owned enterprises, respectively.

To ensure credit availability to IMEs, w.e.f 14 February 2024, the Ministry of MSME made a special provision under the existing CGS for MSEs providing that IMEs registered on UAP can avail of credit up to ₹20 lakh without primary security and with 85 per cent guarantee coverage and a reduced annual guarantee fee. Additionally, initiating legal action is not required for financial institutions to invoke the guarantee.

2.20 Bank credit disbursal to the services sector remained resilient despite a slowdown in credit growth to NBFCs. Within the services sector, credit disbursal to the 'commercial real estate' and 'trade' sub-sectors improved in H2 of FY24. Personal loans and NBFCs have the largest share of credit disbursed by banks. Within personal loans, housing loan growth remained range-bound during FY24, with signs of improvement in April and May 2024.

Chart II.6: Broad-based growth in bank credit across sectors



Source: Deployment of Bank Credit by Major Sectors, Handbook of Statistics on Indian Economy, Table No. 170, RBI
Note: Data includes the impact of merger of a non-bank with a bank

2.21 Credit disbursal for housing loans increased from ₹19.9 lakh crore in March 2023 to ₹27.2 lakh crore in March 2024. Credit growth in personal loans can be attributed to the significant digitalisation of the ecosystem with increased use of credit bureaus for faster decisions, data collation and validation and e-commerce transactions. However, personal loan growth moderated after December 2023 due to increased capital requirements for unsecured personal loans, credit cards and lending to NBFCs by the RBI from 100 per cent to 125 per cent.[14, 15]

Improvement in asset quality of banks

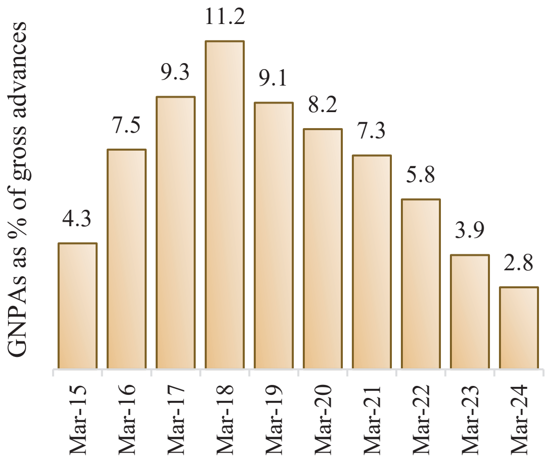
2.22 There has been a significant enhancement in the asset quality of banks, led by improved borrower selection, more effective debt recovery and heightened debt awareness among large borrowers.[16] In addition to regulatory capital and liquidity requirements, qualitative metrics such as enhanced disclosures, robust code of conduct, and transparent governance structures have also improved banking performance.

2.23 The gross non-performing assets (GNPA) ratio of SCBs continued its downward trend, reaching a 12-year low of 2.8 per cent at the end of March 2024 from its peak of 11.2 per cent in FY18. Lower slippages and a reduction in outstanding GNPAs through recoveries, upgradations

[14] RBI notification, 'Regulatory measures towards consumer credit and bank credit to NBFCs', dated 16 November 2023, https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12567&Mode=0
[15] As per the RBI Annual Report 2023-24
[16] Ibid 15

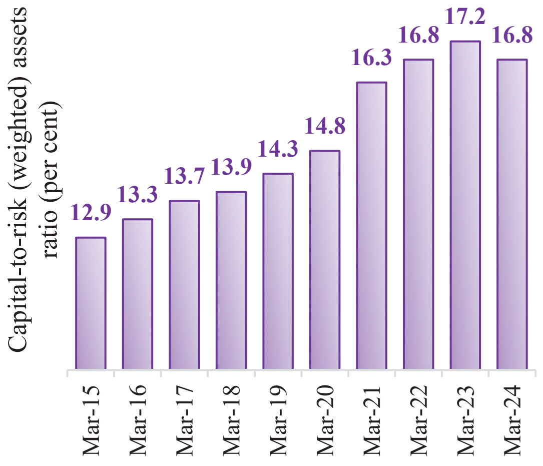
and write-offs led to this decrease. The improvement in SCBs' asset quality has been broad-based. The GNPA ratio of the agriculture sector remains high at 6.5 per cent at the end of March 2024, but it has recorded persistent improvement during H2 of FY24. The GNPA ratio in the personal loans segment improved across all categories. Asset quality improved across all significant sub-sectors within the industrial sector, barring vehicles and transport equipment. Lower GNPAs and high provisions accumulated in recent years contributed to a decline in net NPAs.

Chart II.7a: Decline in GNPAs of SCBs



Source: Handbook of Statistics on Indian Economy, Money and Banking, Gross and Net NPAs of SCBs-Group-wise, RBI

Chart II.7b: CRAR well above the required norms



Source: Handbook of Statistics on Indian Economy, Money and Banking, Distribution of SCBs by CRAR, RBI

2.24 As SCBs bolstered their capital base by capitalising reserves from higher profits and raising fresh capital, their CRAR increased to 16.8 per cent at the end of March 2024. As of the end of March 2024, all banks met this as well as the CET-1 ratio[17] requirement of 13.9 per cent, well above the regulatory minimum.

2.25 The net interest margin (NIM) of SCBs remained robust at 3.6 per cent in March 2024. With growing net interest income and other operating income and as the need for additional provisions fell, their profit after tax rose by 32.5 per cent (YoY) in March 2024, in spite of a large increase in operating expenses. Profitability indicators remained strong, with return on equity (RoE) and return on assets (RoA) ratios touching decadal highs in March 2024. Lagged effects of transmission of monetary policy rate increases and shifts in liquidity conditions led to a 100 basis points increase in the cost of funds as against the 75 basis points rise in the yield on assets in FY24. The yield on assets further improved due to the rise in interest rates.

2.26 It is important to note that in its annual report on 'Trend and Progress of in Banking in India 2021-22', RBI observed that a high NIM is negatively correlated with financial stability. Still, the threshold above which a high NIM is antithetical to financial stability is 5 per cent. The

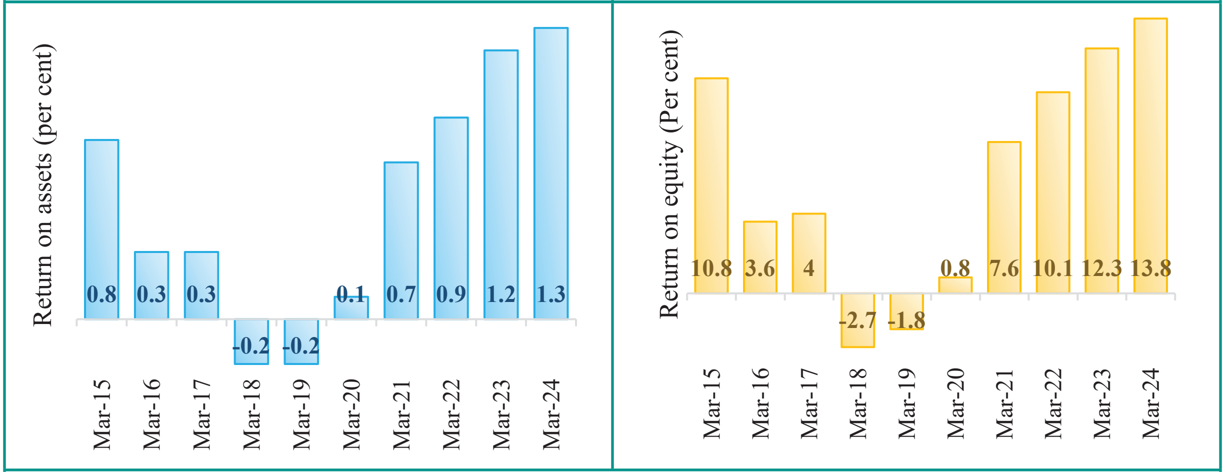
[17] Common Equity Tier 1 refers to the sum of common shares (equivalent for non-joint stock companies) and stock surplus, retained earnings, other comprehensive income, qualifying minority interest and regulatory adjustments

NIM of SCBs is well below that. It peaked at 3.9 per cent in Q1 of FY24, after which it moderated to 3.6 per cent as of March 2024.

Consistent improvement in performance indicators

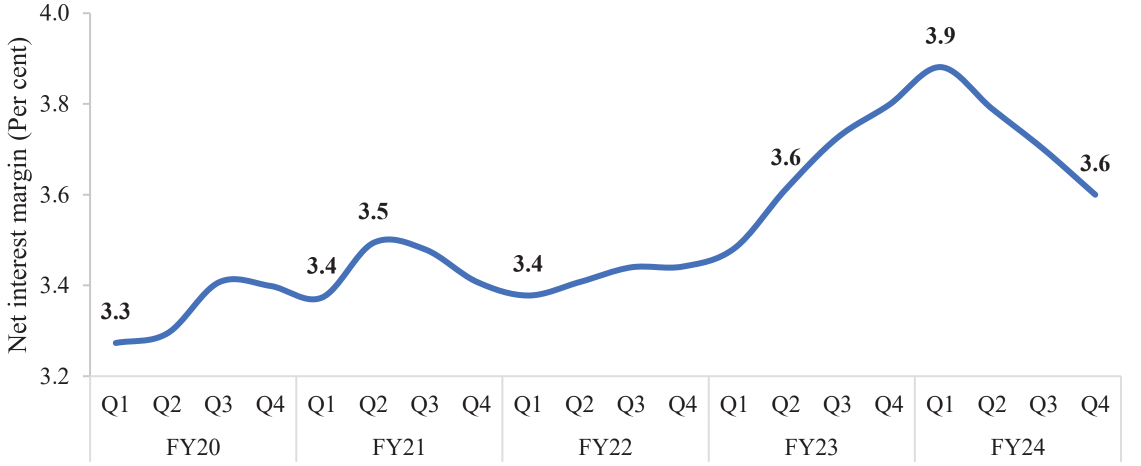
Chart II.8a: Return on assets (Annualised)

Chart II.8b: Return on equity (Annualised)



Source: Chapter II of the RBI Financial Stability Report, 'Financial Institutions: Soundness and Resilience' (various issues)

Chart II.9: High net interest margin of SCBs



Source: RBI

2.27 India's banking sector has shown remarkable resilience. The macro-and micro-prudential measures by RBI and the Government have enhanced risk absorption capacity in recent years, improving the banking system's stability. The RBI's Basic Statistical Returns 2 (Deposits with SCBs) reveal that as of March 2024, 56.9 per cent of India's deposits are with Public Sector Banks (PSBs). 61.1 per cent of total deposits are owned by households considered sticky retail customers; therefore, deposit withdrawals in this category, in case of an adverse event, are likely to remain limited. Second, for the top 10 Indian banks in asset size, loans constitute more than 50 per cent of their total assets, making banks immune to the rising interest rate cycle. Third, after a phase of recapitalisation and cleaning up of bank balance sheets during the past years, there is a visible improvement in various banking indicators. The CRAR for the top 10 SCB (based on asset size) has been well above Basel III Norms. Fourth, interest rate cycles have been quite prominent in India, aligning with RBI's financial conditions and goal to maintain economic stability and manage inflationary pressures. The exposure to regular interest rate cycles has made Indian banks well-equipped to handle the cycles.

2.28 Based on the analysis mentioned above, it is seen that the Indian banking system remains sound and resilient, backed by high capital adequacy ratio, improved asset quality and robust earnings growth. The trend of improvement in the profitability of SCBs, which began in FY20, continued for the fifth consecutive year in FY24. This has been aided by higher income and lower provisions and contingencies.

Dealing with distressed assets

2.29 The ability to resolve stress in the market is a measure of an economy’s soundness, and the ability to do so in the face of an economic slowdown is an essential indicator of the economy’s resilience. The last decade saw Indian commercial banks face a crisis due to the significant burden of NPA. As of March 2016, the GNPA ratio of the public sector banks was 14.5 per cent. The other side of this was the plateauing of the bank debt, which fuelled an increase in corporate leverage, leading to the twin-balance sheet problem. Maximum stress was in the industry and infrastructure sectors.

2.30 The Government has paid close attention to resolving stress in banks and corporations over the past decade. Measures such as strengthening the banking regulatory framework, amending the recovery laws, enacting comprehensive insolvency and bankruptcy legislation, and establishing a public sector asset reconstruction company were implemented. These measures have nursed the credit sector back to sound health, and the GNPA ratio shrunk to 2.8 per cent in March 2024.

2.31 The emergence of stress in the market due to the operation of market forces and the subsequent business/venture failures is a sign of an active and dynamic economy. Since banks form the most significant and predominant source of finance for businesses in India, banks need to be equipped to deal with the flow of distressed assets, and the markets need to be equipped to channel investments into the reconstruction and revival of such assets.

2.32 Banking regulations provide for monitoring and timely identification of stressed assets, and RBI has taken several measures to strengthen its prudential framework. Regulations also provide measures to address stress at its initial stages through restructuring and rescheduling loans. The broad contours of these options form a part of banks' risk management tool kit. Banking regulations form the first line of defence and measures to address stress. The RBI updates them in response to market needs and economic conditions.

Conventional channels of recovery and reconstruction

2.33 The recovery routes viz., Debt Recovery Tribunals (DRTs) and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002, form the second line of measures available to address stress. During FY23, around 45 per cent of the reduction in GNPAs of SCBs was contributed by recoveries and upgradations.[18]

2.34 The Asset Reconstruction Companies (ARCs)[19] regulated under the SARFAESI Act are emerging as an alternative channel for investors, including FPIs , to access the NPAs/distressed assets held by banks. During FY23, 28 ARCs were operating in the market.[20] Such acquisition is done by issuing security receipts (SRs), and ARCs are mandated to take at least 15 per cent of the SRs issued or 2.5 per cent of the total SRs issued, whichever is higher. The regulatory framework has allowed the ARCs to participate as resolution applicants under the IBC process subject to certain conditions. It has thereby allowed harnessing the synergies and complementarities of the two market channels of asset reconstruction. During FY23, 9.7 per cent of the previous year's stock of SCBs' GNPAs was sold to ARCs, compared to only 3.2 per cent in FY22. The number of SRs ultimately redeemed increased during FY23, indicating enhanced recovery through this mode.

2.35 The prerequisites for an efficient market for the NPAs are that it should be deep, competitive and have adequate liquidity. The market has to have enough investors to ensure that the price discovery of the NPAs is efficient. It has to have adequate liquidity to support acquisition from the banks and support asset's turn-around. Apart from direct measures taken to reduce the GNPAs, the Government is building systemic strength in the market with market-based interventions to improve liquidity and competition by establishing a bad bank and encouraging the insolvency and bankruptcy ecosystem.

2.36 The Securities and Exchange Board of India (SEBI) has implemented several measures to improve liquidity in the market for distressed assets. FPIs are permitted to invest in debt instruments issued by companies undergoing resolution and in SRs issued by ARCs. No minimum investor limit or residual maturity requirement is imposed on FPIs for these investments. These measures have led to an increase in FPI investment in SRs issued by ARCs from around ₹10,000 crore to ₹14,482 crore during FY22[21]. SEBI also opened a particular route in 2022, the Special Situation Fund, a sub-component of the Alternative Investment Funds, to participate in the distressed asset market. It allowed these investment vehicles to invest in SRs issued by ARCs and to act as resolution applicants under the IBC process subject to certain conditions. With increased access to funds, market participants are likely to invest in more NPAs/distressed assets, and the recovery rate for banks is expected to be higher.

[18] RBI Report on Trend and Progress of Banking in India 2022-23, Page 80, https://shorturl.at/dOXt1

[19] ARCs are entities registered with the RBI and are permitted to acquire financial assets, including loans, advances, bonds, guarantees and letters of credit from banks/financial institutions for reconstruction

[20] https://tinyurl.com/56vmwnkv

[21] RBI Report on Trend and Progress of Banking in India 2021-22, https://shorturl.at/yx9n4

Increasing competition in the distressed asset market

2.37 To deepen the distressed asset market further, the Government, in July 2021, set up the National Asset Reconstruction Company Ltd. (NARCL) and India Debt Resolution Company Ltd. (IDRCL). NARCL acquires assets from banks, and the Government guarantees back the SRs issued against these assets. The India Debt Resolution Company Ltd (IDRCL) has an exclusive arrangement with NARCL to resolve assets acquired by the latter. The IDRCL is mandated to identify the appropriate resolution strategy for the asset and to aid NARCL in optimal resolution outcomes. The assets acquired by the NARCL clear the bank balance sheets immediately, freeing capital for further lending.

2.38 NARCL has so far acquired 18 accounts with loan exposure of around ₹92,000 crore[22], which includes the acquisition of the ailing Srei Infrastructure Finance Ltd and Srei Equipment Finance Ltd as resolution applicants. While offers on assets worth ₹1.25 lakh crore are at different stages of acquisition, due diligence, and evaluations for assets of around ₹40,000 crore are underway. The establishment of a government-backed company for the aggregation and resolution of distressed assets will further improve liquidity and competition in the market.

Addressing distressed assets through insolvency resolution

2.39 The IBC has been recognised as an effective solution for the twin balance sheet problem, where banks are under the stress of NPAs while corporates are overleveraged and unable to repay their debt. The Code provides for addressing financial distress early in time. It mandates the insolvency professional to conduct the insolvency process and run the operations of the distressed corporate debtor. At the same time, the committee of creditors steers the resolution process and all significant decisions, thus reducing further erosion of value during the process itself. By design and operation, the Code balances the needs of all stakeholders. IBC has provided an avenue for corporate debtors to resolve their debt and get an honourable exit from failed business endeavours, thus promoting ease of doing business and encouraging entrepreneurship. The Code has established itself as an effective solution for addressing banks' stress by aiding in significantly reducing GNPAs and helping rescue failing corporate debtors. It has offered fresh impetus to the recovery segment of the financial markets and the reconstruction of failed/distressed assets in the real sector. In the eight years since 2016, 31,394 corporate debtors involving a value of ₹13.9 lakh crore have been disposed of (including pre-admission case disposals) as of March 2024. The loss of control immediately after admission into the resolution process has led debtors to settle with creditors as soon as the applications are filed with the National Company Law Tribunal (NCLT). A singularly notable fact is that ₹10.2 lakh crore of underlying defaults were addressed at the pre-admission stage.[23] This change in debtor

[22] Data of the Department of Financial Services

[23] Source: IBBI newsletter, January-March 2024, https://ibbi.gov.in/uploads publication/21aa7620a9e809f7a20b432eec89888b.pdf

behaviour has been a big boon for banks and other lending institutions. The Code has created an optimal incentive-disincentive mix to facilitate above-board and transparent dealings in creditor-debtor relations.

Remarkable progress in cases resolved under the IBC and realisation by creditors

Chart II.10a: Number of resolved cases through approved resolution plans

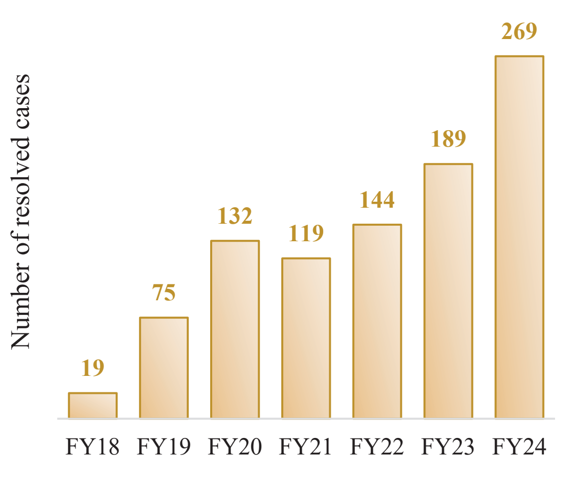
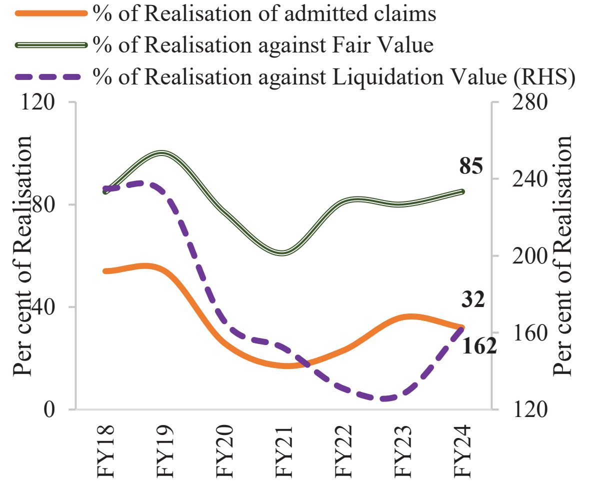


Chart II.10b: Realisation by creditors



Source: Quarterly newsletter released by the Insolvency and Bankruptcy Board of India (IBBI) (various issues)

2.40 The Code uses the corporate insolvency resolution processes (CIRPs) to identify the best means to resolve a distressed asset. It has facilitated the successful closure of 4,131 CIRPs until March 2024. 3,171 corporate debtors have been rescued, of which 947 cases have been resolved through approved resolution plans, which brought in a realisable value of ₹3.36 lakh crore. In the resolved cases, the creditors recovered approximately 32 per cent of their claims. This amounted to a recovery of 85 per cent of the fair value and 162 per cent of the liquidation value of assets.

2.41 The impact of IBC on the health of the financial markets is evident as it is the dominant recovery route for SCBs today.[24] As per the RBI's Report on Trends and Progress of Banking in India, 2022-23, the IBC held a share of 43 per cent of the total amount recovered by SCBs in FY23. In the six years since FY18, the IBC has enabled over ₹3 lakh crore recovery for the SCBs, more than what they have recovered through the Lok Adalats, DRTs, and the SARFAESI Act.

2.42 More significant to the real sector is that over 3,000 businesses have emerged out of the CIRP, with continued business operations extending the productive use of resources trapped due to financial distress in these corporate debtors. A study conducted by the Indian Institute of Management, Ahmedabad, reports[25] that the resolved firms that went through the resolution process under the Code have witnessed a significant improvement in their performance in

[24] It is important to note that the foremost objective of the Code is resolution of stressed corporate debtors. Recovery of claims is only incidental to the process of resolution.

[25] IIM Ahmedabad report, 'Effectiveness of the Resolution process: From Outcomes in the Post-IBC Period', https://ibbi.gov.in/uploads/resources/59f737b213b4700cc16428aefd62869a.pdf

terms of increase in tangible assets and average capex in the post-resolution period compared to the pre-resolution period, the aggregate market valuation of resolved firms rose from around ₹2 lakh crore in the pre-resolution phase to ₹6 lakh crore in the post-resolution phase. There is a substantial increase in total employment and around a 50 per cent increase in the average employee expenses in the resolved firms (listed) in the three years post-resolution. It is hard to find another policy measure that has created winners.

2.43 As of March 2024, the total CIRPs ending in liquidation were 2,476. Around 77 per cent of these corporate debtors were defunct at the beginning of the process and were, on average, valued at 7 per cent of the outstanding debt. The liquidation process provides a last window of opportunity for the revival of the asset through a going concern Sale/Compromise/Arrangement to maximise the value rescued. Around 50 businesses have been rescued at this last resort. 586 firms were dissolved at the end of the liquidation process, releasing whatever resources were needed for alternate uses.

2.44 Nine of the twelve large accounts[26] referred by the RBI for resolution under the IBC have been resolved. The resolution plans for these corporate debtors yielded 54 per cent of the claims admitted. These debtors included steel and power majors such as Electrosteel Steels Ltd., Bhushan Steel Ltd., Monnet Ispat & Energy Ltd., Essar Steel India Ltd., Bhushan Power & Steel Ltd., etc., and their resolutions played a significant role in the revival of the steel sector. The framework under Section 227 of the IBC provides for the resolution of financial service providers, and, at present, NBFCs, including Housing Finance Companies with asset size of ₹500 crore or more, are covered. The framework has enabled the resolution of Dewan Housing Finance Corporation Ltd., Srei Equipment Finance Limited and Srei Infrastructure Finance Limited under this framework. In each case, the creditors have recovered around 42 per cent of the claims. Box II.2 discusses the role of the IBC process in resolving financial stress of real estate companies.

Box II.2: Role of IBC in reviving stalled real estate projects and strengthening homebuyers' rights

Before 2016, the only remedy available for homebuyers whose housing projects were stalled for various reasons was through the Consumer Forums established under the Consumer Protection Act of 1986. In FY24, over 5,500[27] cases were filed with the National Consumer Dispute Redressal Commission, and almost 21 per cent were related to the housing sector. However, the number of cases resolved through the consumer redressal route has been minimal. It was estimated that 4.1 lakh dwelling units in real estate projects across the country involving ₹4.1 lakh crore were under stress.[28]

[26] The first set of corporate debtors referred by RBI for resolution under the IBC.

[27] CONFONET Dashboard at https://cms.nic.in/ncdrcusersWeb/dashboard.do?method=loadDashBoardPub as reflected on 21 May 2024

[28] Model Building Bye-Laws 2016 Towns and Country Planning Organisation, Ministry of Housing and Urban Affairs, https://mohua.gov.in/upload/uploadfiles/files/report(1).pdf

The year 2016 saw the enactment of the Real Estate (Regulation and Development) Act 2016 (RERA Act). This provided a dedicated grievance redressal mechanism to the aggrieved homebuyers and a means to rein in errant real estate contractors and companies. Subsequent enactment of the IBC in the same year opened another channel and has been the most favoured among the three available remedies. As of March 2024, over 1500 real estate companies were admitted into the insolvency resolution process under the IBC, accounting for 21 per cent of total admissions. One in four cases settled after admission was also from this sector. Of the 891 corporate debtors resolved, 133 were real estate companies, forming 15 per cent of the companies resolved.

Insolvency resolution of real estate companies posed a unique set of challenges for the standardised corporate insolvency process. Real estate companies have multiple projects spread across geographies, projects at different stages of construction, and diversified business models. The large number of homebuyers across these projects meant claims from thousands of homebuyers who needed to be included in the process. The judiciary, the Government, and the market have recognised these difficulties and moved in cohesive steps to improve outcomes for these projects. The availability of two new remedial routes led to discord and friction in the system.

The Insolvency Law Committee, in its March 2018[29] report took cognisance of the peculiarity of the real estate sector. It recommended that the amount raised from homebuyers be considered financial debt as it formed a significant contribution to finances raised and had the commercial effect of borrowing. This led to substantial changes in the CIRP by making homebuyers a distinguished class of creditors and a part of the Committee of Creditors, enabling their direct participation in decision-making. A system to organise and derive decisions, through consensus of majority voting of the thousands of homebuyers, was also worked out to introduce insolvency professionals as authorised representatives. Further amendments enabled insolvency to be initiated by a joint application of not less than 100 allottees or not less than 10 per cent of the total number of allottees under the same project, ensuring that frivolous applications are not filed. As clarity emerged on the use of IBC as a remedy for homebuyers, it was also laid out that resolution plans approved for real estate projects should necessarily be compliant with the RERA Act, thereby restoring primacy to the sectoral law and the sectoral regulator in its domain for optimal oversight of the sector.

By way of innovation in economic law, the judiciary paved the way for solutions in resolving real estate corporate debtors. As a class of creditors, it enabled homebuyers to act as resolution applicants. It approved what was termed a "reverse CIRP", where the corporate debtor could take measures to complete the project even as the resolution process was underway. The judiciary has allowed project-specific resolution plans, targeting the affected project alone under the same corporate debtor. This measure relieved the corporate debtors and allottees of different projects, and the market has responded positively.

[29] Ministry of Corporate Affairs report of the Insolvency Law Committee, March 2018, https://ibbi.gov.in/uploads/resources/ILRReport2603_03042018.pdf

Several real estate companies have successfully resolved and enabled the progress of stalled projects. In the case of Value Infracon India Private Limited, the resolution process yielded creditors 98 per cent of the claim value and 189 per cent of the asset's liquidation value.

In the cases of Ashiana Landcraft Realty Private Limited and Anudan Properties Private Limited, the resolutions yielded around 2.5 times the liquidation value of the assets. Large corporate debtors in the sector, like Jaypee Infratech Limited, have been resolved with a recovery of 88 per cent for creditors, and assets have been acquired at over 114 per cent of liquidation value.[30]

Even as the pace of resolutions picked up under the IBC, there was still a need to channel/ redirect investments into these stressed projects. To address this vital gap, the Government set up the Special Window for Affordable and Mid-Income Housing (SWAMIH) with a target corpus of ₹12,500 crore in 2019. It is a professionally managed Alternative Investment Fund (AIF) aimed at providing priority debt financing for the completion of stalled housing projects, including corporate debtors and projects undergoing the resolution process under the Code. As of April 2024, the SWAMIH Fund has delivered 32,000+ homes and the delivery of 20,000 homes every year for the next three years is being targeted.

The impact of seamless resolutions and progress of cases under IBC and improvement in liquidity through the AIF is reflected in the healthy balance sheets of banks, thereby enhancing their ability to lend further.

2.45 The Government has taken several measures to improve the insolvency ecosystem. It has strengthened the NCLT regarding infrastructure, increasing its strength by filling vacancies and proposing an integrated IT platform. The regulations have been amended to keep in line with the needs of the markets and the advances in judicial pronouncements. The IBC has established itself as an indispensable component of the asset recovery and reconstruction market. In the process, it has forever changed the credit market landscape in the country for good.

Financial inclusion is within reach; digital financial inclusion is the next goal

2.46 Financial inclusion is not just a goal but also a means to an end as an enabler for sustainable economic growth, reduction of inequality and elimination of poverty. The United Nations (UN) has positioned financial inclusion as a prominent enabler of other development goals in the 2030 Sustainable Development Goals (SDGs). Academic evidence states that financial inclusion can enhance overall economic growth and facilitate the achievement of different SDGs.

2.47 The Government has prioritised delivering financial services to the last mile. Given the low levels of financial inclusion and formal identification in 2008, the magnitude of the challenges facing India a little over a decade ago was immense. According to the World Bank's Global Financial Inclusion Database, India has made remarkable progress in its financial inclusion goals over the past ten years. The number of adults with an account in a formal financial institution increased from 35 per cent in 2011 to 77 per cent in 2021. There has been

[30] As per data as reflected in the summary of outcomes released by IBBI, https://ibbi.gov.in/en/claims/cd-summary

an increase in the percentage of adults saving in a financial institution and borrowing from formal sources. There is a decline in the access gap between the rich and the poor. Further, the gender divide in terms of financial inclusion has also narrowed. While progress has been made on gender in financial inclusion, India's youth are seeing the same benefits (Table II.2). Compared to South Asian and world averages, it is seen that India's performance is better in specific indicators (Table II.3).

2.48 Based on the bank account data and the relationship with GDP per capita, one rough estimate is that it would have taken 47 years to achieve 80 per cent of adults with a bank account had India solely relied on traditional growth processes.[31]

Table II.2: India's performance across indicators of financial inclusion and financial education

S.No.	Indicators of Financial Inclusion	2011	2021
1.	Adults with an account at a formal financial institution (%, age 15+)	35	77
2.	Made or received a digital payment (% age 15+)	22*	35
3.	Borrowed from a formal financial institution, older (% age 15+)	8	12
4.	Account, poorest 40% (% age 15+)	27	78
5.	Account, richest 60% (% age 15+)	41	77
6.	Account, female (% age 15+)	26	78
7.	Account, male (% age 15+)	44	78
8.	Youth (age 15-24 years) made or received digital payment	19*	30

Source: World Bank's Global Financial Inclusion Database
Note: *data is for 2014, as data for 2011 is not available

Table II.3: A cross-country comparison of financial inclusion and financial education parameters

	Adults with an account at a formal financial institution (%, age 15+)	Adults saving at a financial institution (% ages 25+)	Borrowed from a formal financial institution, older (% age 25+)
World	**76**	**29**	**32**
South Asia	68	11	12
Brazil	84	23	42
China	89	45	42
India	**78**	**13**	**13**
Indonesia	52	20	15
South Africa	85	37	20

Source: World Bank's Global Financial Inclusion Database, Data for 2021 (latest available)

2.49 More recently, there has been a shift in focus of the financial inclusion strategy in the country, from 'every household' to 'every adult,' with added emphasis on the usage of accounts

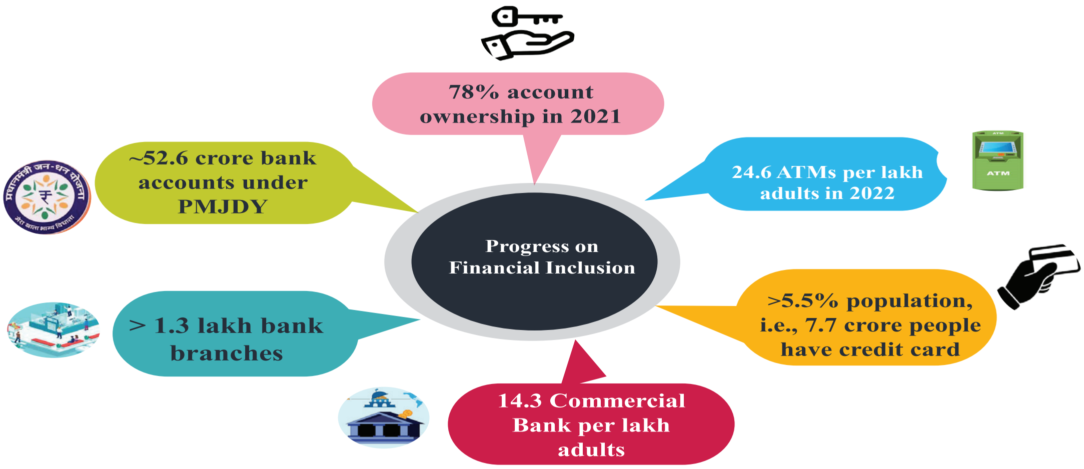
[31] BIS Papers No 106: The design of digital financial infrastructure: lessons from India by Derryl D'Silva, Zuzana Filková, Frank Packer and Siddharth Tiwari, Monetary and Economic Department, December 2019, (https://www.bis.org/publ/bppdf/bispap106.pdf)

by enhancing direct benefit transfer (DBT) flows through these accounts, promoting digital payments using RuPay cards, UPI etc. The RBI launched UPI123Pay in March 2022 as an option to make UPI payments for feature phones, and the National Payments Corporation of India (NPCI) introduced UPI Lite, an on-device wallet service provided by select banks that allows low-value transactions up to ₹200 through the BHIM app. These innovations are steps towards accelerating the digital adoption process in India by creating a more prosperous and inclusive ecosystem that can accommodate larger sections of the population. India is also collaborating with several countries to bring more efficiency to national and cross-border payment systems.

2.50 RBI has been collaborating bilaterally with various countries to link India's Fast Payments System (FPS), i.e., UPI, with their respective FPSs for cross-border Person to Person (P2P) and Person to Merchant (P2M) payments. The RBI joined Project Nexus, a multilateral international initiative to enable instant cross-border retail payments by interlinking domestic FPSs. The Nexus aims to connect the FPSs of four ASEAN countries (Malaysia, Philippines, Singapore, and Thailand) and India, who would be the founding members and first mover countries of this platform. An agreement to this effect was signed by the BIS and the central banks of the founding countries on 30 June 2024.[32] The platform is expected to go live by 2026. Once functional, Nexus is expected to play an important role in making retail cross-border payments efficient, faster, and more cost-effective.

2.51 The main components of the RBI's strategy for financial inclusion have been a target-based approach, market development, strengthening infrastructure, innovation, and technology, last-mile delivery, consumer protection and financial literacy and awareness.[33] Following this strategy, the progress on financial inclusion so far is presented below:

Progress on financial inclusion in India


78% account ownership in 2021
~52.6 crore bank accounts under PMJDY
24.6 ATMs per lakh adults in 2022
Progress on Financial Inclusion
> 1.3 lakh bank branches
>5.5% population, i.e., 7.7 crore people have credit card
14.3 Commercial Bank per lakh adults
ATM

Source: Pradhan Mantri Jan Dhan Yojana (PMJDY) website, PIB and RBI
Note: Data as of July 2024

[32] BIS press release dated 1 July 2024, 'Project Nexus completes comprehensive blueprint for connecting domestic instant payment systems globally and prepares for work towards live implementation', https://www.bis.org/press/p240701.htm

[33] The RBI launched a National Strategy for Financial Inclusion 2019-2024, with the vision to help expand and sustain the financial inclusion process at the national level through a broad convergence of actions involving all the stakeholders in the financial sector. The strategy aimed to provide affordable access to formal financial services, broaden and deepen financial inclusion, and promote financial literacy and consumer protection.

Digital Financial Inclusion

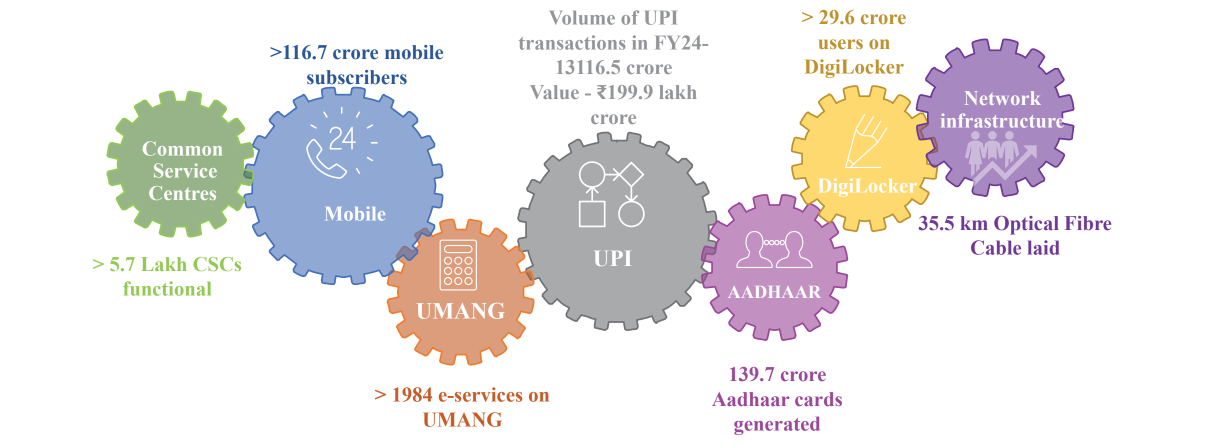
2.52 A key enabler of this financial inclusion drive has been the digitalisation of the financial system, which has catalysed the transformation of the financial services landscape worldwide. With financial services now available on tap on digital devices, the next big challenge is to ensure 'Digital financial inclusion (DFI).' DFI involves arranging cost-effective digital means to reach currently financially excluded and underserved citizens with a range of formal financial services suited to their needs. The essential components of DFI include the availability of digital transactional platforms to enable customers to make or receive payments and devices to enable such transactions. These retail agents have digital devices and additional financial services via a digital transactional platform.

2.53 While measures were afoot towards digitisation of financial services in India, the COVID-19 pandemic gave further momentum to the process when the most vulnerable and excluded citizens were severely affected. The Government, accordingly, encouraged innovation and developed a well-stacked digital infrastructure and technology-led system. This has evolved into an inclusive, cost-efficient, and responsible DPI.

2.54 With the objective of India emerging as a fintech nation, the Government has launched many flagship schemes such as the Digital India Mission, Make-in-India, etc. Greater emphasis has been given to the creation of DPI such as Aadhaar, e-KYC, Aadhaar-enabled Payment System, UPI, Bharat QR, DigiLocker, e-sign, Account Aggregator, Open Network for Digital Commerce, etc. These DPIs can be utilised on a shared basis by different players to ensure optimum outcomes. Their usage has brought transparency, scale operation and timely delivery of financial services to the public.

2.55 India's robust DPI has played a pivotal role in enabling the country's digital transformation, providing citizen-centric and transparent governance services. India's fast-growing population, world-class DPI, and proactive regulations have underpinned the Fintech industry's growth. India is among the fastest-growing fintech markets in the World, hailing as the third-largest growing fintech economy.

India's Digital Public Infrastructure: Churning the wheels of the economy


Volume of UPI transactions in FY24- 13116.5 crore Value - ₹199.9 lakh crore
> 29.6 crore users on DigiLocker
>116.7 crore mobile subscribers
Network infrastructure
Common Service Centres
Mobile
DigiLocker
35.5 km Optical Fibre Cable laid
UPI
> 5.7 Lakh CSCs functional
AADHAAR
UMANG
139.7 crore Aadhaar cards generated
> 1984 e-services on UMANG

Note: Figures as of July 2024,
Source: Dashboard of respective schemes/programmes

2.56 Advances in DFI have enabled millions of people in the formal and vast informal economy to accept payments, settle invoices, and transfer funds anywhere in the country with just a few screen taps. These advances are built on the India Stack, a comprehensive digital identity, payment, and data-management system. India Stack consists of three interconnected layers that provide a digital identity to every Indian while facilitating easy, cost-free, mobile-first digital transactions. The three critical components of India Stack[34] are the Identity Layer, payment layer and data governance layer. Regarding the identity layer, Aadhaar has been instrumental in transforming India's authentication ecosystem. It has facilitated the KYC process, reducing the cost of conducting e-KYC from USD 12 to 6 cents, extending banking to millions of Indians and improving financial inclusion. In the case of the payment layer, the UPI has revolutionised the country's payment system. The success of UPI has been enhanced by the expansion of smartphone usage in India, with more than 116.5 crore smartphone subscribers as of 31 March 2024.[35] The value of transactions conducted on the UPI platform has increased multifold from ₹0.07 lakh crore in FY17 to ₹200 lakh crore in FY24.[36] The data governance layer focuses on ensuring ownership and control over the user data to its rightful owners.

2.57 Digital credit can be a powerful agent for sustainable and inclusive growth by empowering individuals and firms to cultivate economic opportunities. According to the International Monetary Fund (IMF) research, an increase in digital financial inclusion in payments leads to a 2.2 per cent rise in average economic growth, likely driven through the consumption channel and higher formalisation.[37]

Microfinance institutions: facilitating financial inclusion

'Access to formal finance can boost job creation, reduce vulnerability to economic shocks and increase investment in human capital. With adequate access to financial services, individuals and firms can rely on costly informal sources of finance to meet their financial needs and pursue growth opportunities. At a macro level, greater financial inclusion can support sustainable and inclusive socio-economic growth for all.'

- National Strategy for Financial Inclusion 2019-24, RBI

2.58 Microfinance refers to providing financial services, including small-value loans to households, small businesses and entrepreneurs who lack access to formal banking services. It is an effective tool for financial inclusion, which involves sustainably providing microfinance and related services to enable the poor and the marginalised to achieve social equity and empowerment. Microfinance has been playing an essential role in meeting low-income households' credit needs by providing affordable doorstep services. They have also played a

[34] World Bank's blog, 'India digital transformation could be a game-changer for economic development', dated 2DFI0 June 2023, https://shorturl.at/Z2rL9

[35] Telecom Regulatory Authority of India (TRAI) report, 'Telecom Subscription Data as of 31 March 2024', page no. 6, https://www.trai.gov.in/sites/default/files/PR_No.23of2024_0.pdf.

[36] National Payment Corporation of India, https://www.npci.org.in/what-we-do/upi/product-statistics

[37] IMF Working Paper, June 2021, 'Is Digital Financial Inclusion Unlocking Growth', https://tinyurl.com/2russwem

role in extending other financial services like insurance, remittance, financial literacy, etc. Microfinance has emerged as one of the most important tools for fostering financial inclusion.

2.59 The evolution of the MFI sector in India has been substantially facilitated by the supportive regulatory framework of RBI coupled with the formulation of an Industry Code of Conduct by the Self-Regulatory Organisations (SROs), such as Sa-Dhan[38] and MFIN.[39] The New Regulatory Framework for Microfinance Loans issued by the RBI for the microfinance sector on 14 March 2022 ensures that all entities operating in the microfinance space are subject to the same regulations, creates a level playing field and safeguards the interest of the borrowers.

2.60 Globally, the Indian microfinance sector is the second largest after China in terms of number of borrowing customers in India, which are about three times that of the next biggest market, i.e., Indonesia. The Indian microfinance coverage (Self-Help Groups (SHGs) and Joint Liability Group (JLG)) is more than 50 per cent of households and 10 per cent of the Indian population.[40]

Table II.4: India has the second-largest microfinance sector

Country	Savers (millions)	Borrowers (millions)	Outstanding loans (USD billion)
Bangladesh (June 2022)	66.4	44.6	17.4
Cambodia (December 2022)	2.7	2.1	9.7
Philippines (December 2020)	–	17.0	7.6
Indonesia (December 2019)	–	56.8	2.1
Pakistan (March 2023)	98.1	9.25	1.8
India (March 2023)			
SHGs	161	83	23.5
MFIs	–	73	44.0

Source: Data from different sources such as industry associations, central bank websites, and academic publications

2.61 As per the 2023 Bharat Microfinance Report, MFIs operate in 28 States, five UTs, and 646 plus districts in India. Two hundred and thirteen MFIs operate in India as of FY23, with a branch network of 25,790, engaging 2.2 lakh employees. Together, they have reached out to over 532 lakh clients with a total loan outstanding of ₹1.8 lakh crore under micro-credit.[41] The addition of new clients reflects the continuing inclusion efforts of the sector and offers hope for the remoter and underserved geographies. As of 31 March 2023, the number of clients with

[38] Sa-Dhan was recognised by the RBI as an SRO for the microfinance sector in the year 2015 to administer industry regulations, tools and performance standards for effective monitoring of MFIs, their compliance with regulations and the Code of Conduct in the best interest of clients. As an SRO, Sa-Dhan has been at the forefront of formulating and administering industry regulations, tools, and performance standards for effective monitoring of MFIs, their compliance with regulations and the Code of Conduct in the best interest of clients.

[39] https://mfinindia.org/

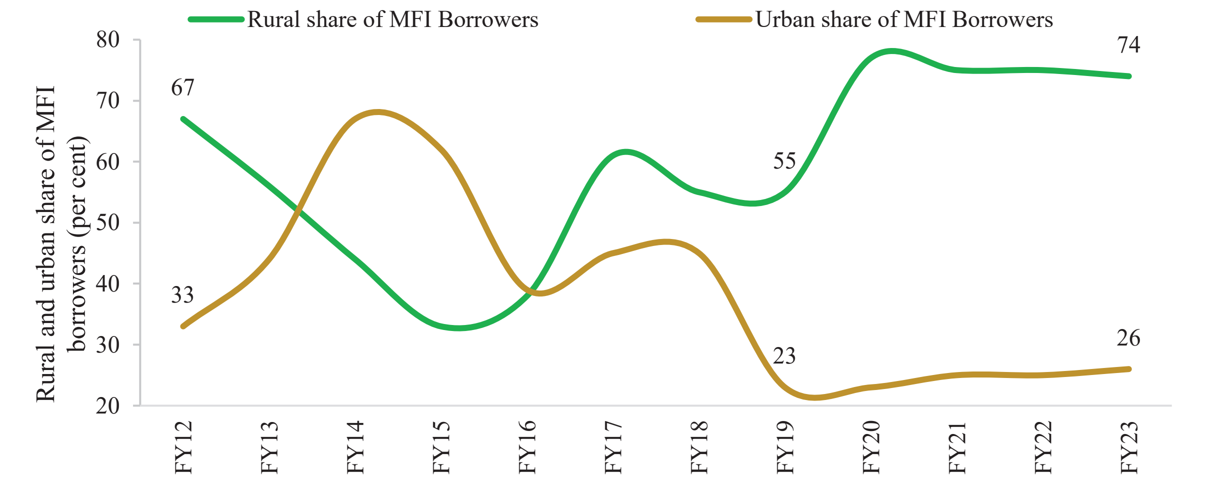
[40] Inclusive Finance India Report, 2023, Access Development Services, https://inclusivefinanceindia.org/wp-content/uploads/2023/12/IFI-Report-2023.pdf

[41] Bharat Microfinance Report, 2023, Sa-dhan, https://rb.gy/hnq8zo

loans outstanding with MFIs, including those overdue over 179 days, was 571 lakhs. Out of these, the active clients (excluding the clients having overdue over 179 days) served by MFIs stood at 532 lakhs, posting a YoY growth of 19 per cent.

2.62 Though MFIs serve both rural and urban poor, they are oriented more towards rural areas in India. Urban borrowers dominated for a while.There is a definite shift thereafter towards the rural sector, and it has continued for the last four years. The present share of the rural clientele is at 74 per cent.

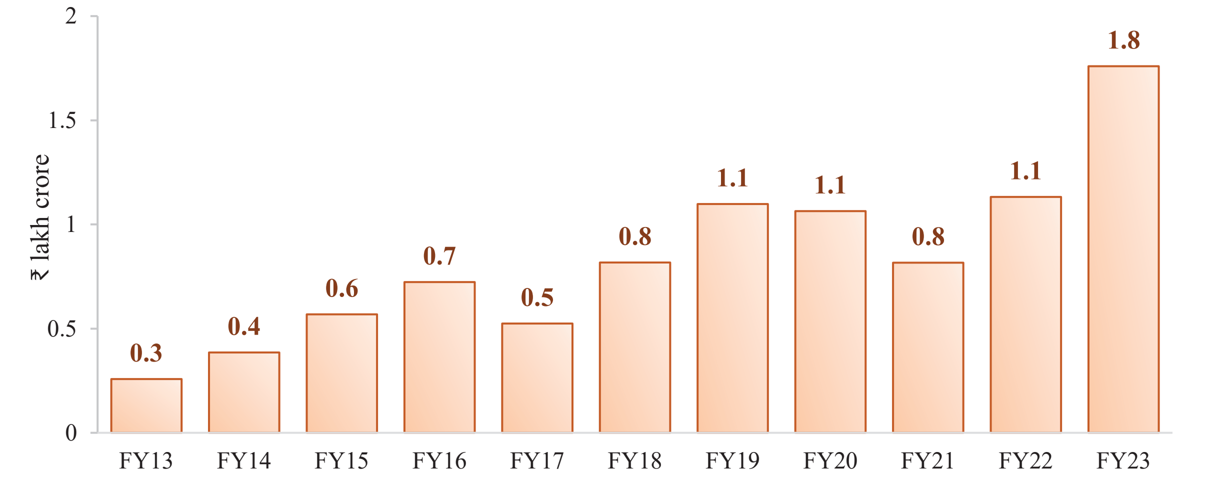
Chart II.11: Rising share of rural MFI borrowers



Source: The Bharat Microfinance Report 2023, Sa Dhan (page 16, Figure 2.8)

2.63 Microfinance is mostly a woman-focused activity. Women constitute 98 per cent of the total clients of MFIs. Further, it also serves other weaker and marginalised sections like scheduled castes (SC), scheduled tribes (ST) and minorities in a significant way. The SC/ST borrowers constitute a substantial 23 per cent of the clients.

Chart II.12: Rise in loan disbursement by MFIs



Source: The Bharat Microfinance Report 2023, Sa Dhan (page 28, Figure 2.18)

2.64 Disbursement of loans by MFIs recorded steady growth throughout, except in some years due to external events like the COVID-19 pandemic, etc. During FY23, the microfinance sector bounced back strongly, achieving an aggregate disbursement of ₹1.8 lakh crore, 55 per cent higher than the previous year.

2.65 The performance and profitability ratios of MFIs during FY23 provide a picture of good health and improving prospects of the industry. The industry managed to trim operating costs while retaining finance costs at more or less the same level as in previous years. The total assets of the MFIs stood at ₹1.5 lakh crore at the end of FY23, 30 per cent higher than the previous year. The sector has been going from strength to strength for the last few years, except for one or two years in between owing to some external events. In FY23, RoA and RoE stood at 2.5 per cent and 12.2 per cent for all MFIs, reflecting an improvement over the previous year. As per the RBI regulatory norms, NBFC-MFIs need to maintain at least 15 per cent of their risk-weighted assets in the form of capital. The capital adequacy of Indian MFIs is largely well above the prescribed norms, with the median CAR for FY23 at 26.5 per cent.

2.66 During FY23, good progress in enhancing portfolio quality has been achieved by the MFIs, as they have been able to rein in defaults, improve recoveries, and deal with chronic cases through settlements and write-offs. The Performance and Accountability Reporting (PAR) 30+ ratios for MFIs are moving towards pre-COVID levels but are still short of the lowest delinquency ratios achieved in FY19. The CRIF-Highmark analysis shows that, during FY23, MFIs were able to reduce forward flows of impaired loans[42] from one bucket to the next in the case of 30, 60, and 90-day PAR. However, the forward flows in the 91 to 180-day buckets increased for MFIs and banks.[43]

2.67 The success of the microfinance sector in rural India can be measured using several indicators. The most extensive microfinance programme, the SHG-Bank Linkage Programme (SHG-BLP), has captured the post-pandemic recovery through the number and amount of SHGs with loans outstanding with banks over FY22 and FY23. During FY23, the credit disbursement under SHG-BLP was ₹1.5 lakh crore, registering a growth of 45.6 per cent. The number of SHGs credit linked during FY23 increased to 43 lakh from 34 lakh in FY22. As of March 2023, the banking system held SHG savings to the tune of ₹58,893 crore with a growth of 24.7 per cent, with average savings per SHG amounting to ₹43,940.[44] The improvement in the RBI's Financial Inclusion Index from 60.1 in March 2023 to 64.2 in March 2024 indicates the strides being made in the area of access, usage, and quality of the financial sector in India.[45]

[42] An impaired loan is a loan that is not performing according to the original terms of the agreement.

[43] Volume XXIII of CRIF Quarterly publication on Microfinance lending, 'MicroLend', March 2023, https://www.crifhighmark.com/media/2921/crif-microlend-vol-xxiii_mar-2023.pdf

[44] Status of Microfinance in India 2022-23, https://shorturl.at/Blzyn

[45] The FI-Index has been conceptualised as a comprehensive index incorporating details of banking, investments, insurance, postal, as well as the pension sector in consultation with the Government and respective sectoral regulators. The FI-Index comprises three broad parameters (weights indicated in brackets) viz., Access (35 per cent), Usage (45 per cent), and Quality (20 per cent), with each of these consisting of various dimensions, which are computed based on a number of indicators.

Trends in indian capital markets

2.68 Despite heightened geopolitical risks, rising interest rates and volatile commodity prices, Indian capital markets have been one of the best performing among emerging markets in FY24, reflecting India's bright economic stature. Capital markets are becoming prominent in India's growth story, with an expanding share in capital formation and investment landscape on the back of technology, innovation, and digitisation. The following sections present the significant trends in primary markets, secondary markets, and institutional investment in India.

Primary Markets

2.69 Amid healthy domestic economic performance and a favourable investment climate, primary markets remained robust during FY24, facilitating capital formation of ₹10.9 lakh crore (which approximates 29 per cent of the gross fixed capital formation of private and public corporates during FY23), compared to ₹9.3 lakh crore in FY23. Of the total amount mobilised in FY24, 78.8 per cent was raised through debt issuances. Fund mobilisation through all three modes, viz., equity, debt, and hybrid, increased by 24.9 per cent, 12.1 per cent and 513.6 per cent, respectively, in FY24 compared to the previous year.

2.70 The number of initial public offers (IPOs) increased by 66 per cent in FY24 from 164 in FY23 to 272 in FY24, while the amount raised grew by 24 per cent (from ₹54,773 crore in FY23 to ₹67,995 crore in FY24). SME platforms at the exchanges witnessed heightened activities during FY24 as the number of IPOs/FPOs (Follow-on Public Offers) of SMEs increased by 1.6 times (from 125 in FY23 to 196 in FY24), while the corresponding fund raised rose by more than two and half times over the previous year (from ₹2,333 crore in FY23 to ₹6,095 crore in FY24). As per E&Y Global IPO trends report, Indian exchanges were global leaders in IPO listings. India's share consistently rose to 17 per cent in 2023 from 6 per cent and 11 per cent in 2021 and 2022, respectively.[46] Reflecting the buoyant market conditions, Qualified Institutional Placements (QIPs)[47] emerged as a critical equity fundraising mechanism for the corporates during FY24. Resource mobilisation through rights issues more than doubled to ₹15,110 crore during FY24, compared to ₹6,751 crore in the previous year.

Public debt issuances

2.71 The corporate debt market in India is going from strength to strength. During FY24, the value of corporate bond issuances increased to ₹8.6 lakh crore from ₹7.6 lakh crore during the previous financial year. The number of corporate bonds public issues in FY24 was the highest for any financial year so far, with the amount raised (₹19,167 crore) at a four-year high. Private placements remained the preferred channel for corporates, accounting for 97.8 per cent of total resources mobilised through the bond market. Increasing investor demand and the rise in

[46] E&Y Press Release on 'Indian stock exchanges rank first in the world in terms of the number of IPOs in 2023' dated 19 February 2024, https://shorturl.at/Lj6Z3

[47] QIP was introduced by SEBI in 2006, under which Indian listed companies can raise funds by issuing equity shares, fully or partially convertible debentures, or any other securities as mentioned under the notification by SEBI in this regard. Listed companies can raise capital without meeting the legal requirements like submitting the pre-issue filings to SEBI.

the cost of borrowing from banks have made these markets more attractive for corporates for funding requirements. The quantum of outstanding corporate bonds increased by 5.5 per cent YoY to ₹45 lakh crore (i.e., 15.5 per cent of GDP) at the end of March 2024.

REITs and InvITs

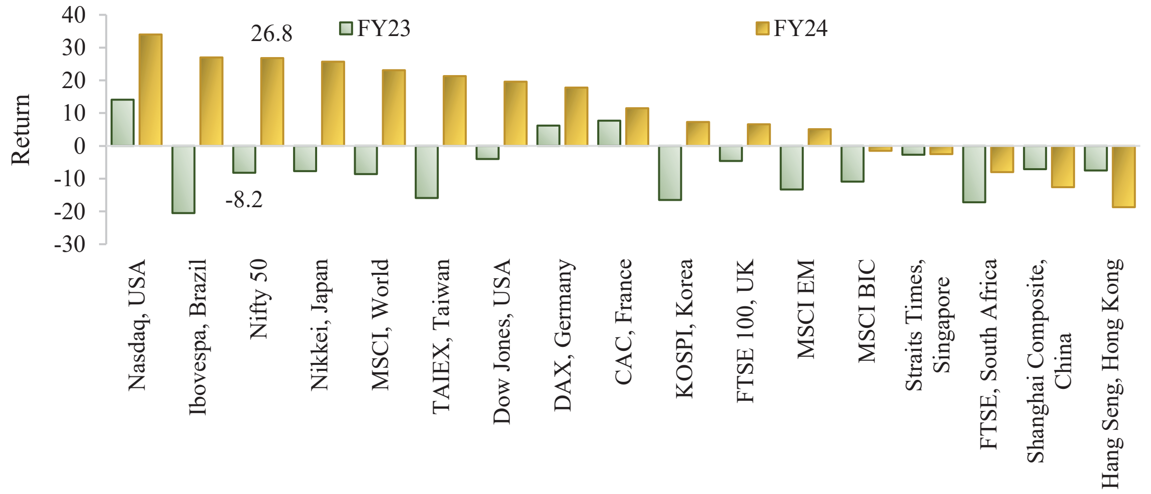
2.72 During FY24, ₹39,024 crore was raised by Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs), more than five times compared to FY23, supported by the Government's thrust on infrastructure development.

Secondary Markets

India among the best-performing markets

2.73 After enduring a highly turbulent global environment in FY23, global stock markets recovered and performed well during FY24. All the major markets, except China and Hong Kong, delivered better returns during the period compared to the previous year. Indian stock market was among the best-performing markets, with India's Nifty 50 index ascending by 26.8 per cent during FY24, as against (-)8.2 per cent during FY23. FY24 saw stellar performances from the US, Brazilian and Japanese markets among the global markets. There was evidence of an AI-led tech stock surge, with the tech-heavy US Nasdaq index rising by 34 per cent during FY24 after delivering heavy losses in FY23.

Chart II.13: Remarkable performance of the Indian Stock Market



Source: Refinitiv for Index Values

2.74 The exemplary performance of the Indian stock market compared to the world and emerging markets over the years can be primarily attributed to India's resilience to global geo-political and economic shocks, its solid and stable domestic macroeconomic outlook, and the strength of the domestic investor base. Mirroring the positive outlook on Indian markets, India's weight in the MSCI-EM index has increased to 17.7 per cent at the end of FY24 from 13.7 per cent at the end of April 23, the second-highest share among the EMs in the index.

2.75 The market capitalisation of the Indian stock market has seen a remarkable surge over the years. Significant interest from domestic and global investors in the Indian stock market as an attractive investment destination and sustained IPO activity placed the Indian market fifth in the world by market capitalisation in FY24. India's market capitalisation to GDP ratio has improved significantly over the last five years to 124 per cent in FY24, compared to 77 per cent in FY19, far higher than that of other emerging market economies like China and Brazil. It is essential to strike a note of caution. The market capitalisation to GDP ratio is not necessarily a sign of economic advancement or sophistication. Financial assets are claims on real goods and services. If equity market claims on the real economy are excessively high, it is a harbinger of market instability rather than market resilience.

2.76 The value traded increased across all segments in the exchanges, except currency derivatives during FY24, with increased investors' participation and positive market trends. Commodity derivatives turnover rose by 87 per cent in FY24, driven by an increase in turnover of options contracts of the energy segment.

Table II.5: Market capitalisation to GDP ratios across countries (percentage)

	India	China	Brazil	Japan	South Korea	United Kingdom	United States
Dec-19	77	60	65	121	89	106	159
Dec-20	95	79	68	129	122	92	197
Dec-21	113	80	50	136	127	108	208
Dec-22	105	65	42	126	96	91	158
Dec-23	124	61	44	147	114	71	179

Note: *GDP figures are taken from the World Federation of Exchanges (WFE), and market capitalisation is calculated as the sum of the market capitalisation of NASDAQ and NYSE
Source: CEIC Database, World Bank, WFE

2.77 Box II.3 discusses the initiatives undertaken to strengthen the capital markets through the use of technology, which have played a significant role in enhancing their performance and efficiency.

Box II.3: The synergy of technology and Indian capital markets: Driving growth and efficiency

Indian capital markets have witnessed a broad-based expansion across various sub-markets, with the country's equity market capitalisation reaching ₹415 lakh crore (USD 5 trillion) in May 2024, placing it fifth in the global rankings.

The proliferation of technology has been a critical catalyst in transforming economies worldwide, and the Indian capital markets have been no exception. The sector has continuously transformed over the past few years, leveraging technological advancements to facilitate growth and efficiency.

Technology plays a role in meeting the market regulator SEBI's three goals: market regulation, investor protection, and market development.

Individual investors today are over 9.5 crore and have nearly 10 per cent direct ownership of the market through its almost 2500 listed companies. This translates to around ₹36 lakh crore of wealth as of March 2024, apart from indirect ownership in equity mutual funds that have ₹28 lakh crore in assets under management (AuM). In this manner, technology allows exchanges to help allocate capital to firms and millions of market investors to invest in companies they have never visited and participate in their long-term success and wealth creation. Overall, the market capitalisation in India has risen by over 100 times in the last three decades.

Technological advancements such as India Stack and regulatory measures have fuelled an unprecedented surge in retail investor participation and activity. The prevalence and proliferation of user-friendly trading apps, mobile-friendly educational resources, and financial market guidance have democratised access to the capital markets.[48] The seamless use of technology has empowered investors to open trading and demat accounts online within minutes, trade from the comfort of their homes, access investment reports, and raise queries online efficiently. Initiatives such as the SEBI Complaints Redress System (SCORES), a platform for investor grievance resolution, and Securities Market Trainers (SMARTs) a program for investor education, have been instrumental in safeguarding the interests of market participants, particularly first-time investors.

Technology has also played a crucial role in market development. India's unique digital architecture has imbued the capital market regulator with the confidence to switch to the "T+1 settlement regime” comfortably, a feat followed by very few countries worldwide.[49] The introduction of “Interoperability” among clearing corporations (CCs) created a one-to-many relationship between stock exchanges and CCs that reduced trading costs via better margin utilisation and capital resources of the participants.[50] Indian capital markets have also adopted on a pilot basis the “Application Supported by Blocked Account” facility in the secondary market, which allows investors to block funds in their bank until trade confirmation. A recent initiative of the National Securities Depository Limited (NSDL) titled NSDL-CAS has further eased the investors' lives by presenting an aggregated view of assets held in demat format across multiple accounts and mutual fund folios.[51]

Beyond growth, investor safety, and market development, business continuity today has become a critical aspect of capital markets. Initiated in 2022, the “Disaster Recovery (DR)

[48] Explained: What's driving increased retail participation in the Indian stock market? Livemint (2024), link available at: https://tinyurl.com/3xetmuvt

[49] Indian equity markets have even transitioned to same-day settlement cycles ("T+0") in a limited manner, becoming the first nation to do so. The transition to shorter settlement cycles has increased efficiency and reduced settlement risk.

[50] Interoperability among clearing corporations, PWC (2019)

[51] Enhancing Investor Centric Services through Technology and Education, AIBI Summit (2022)

45" framework allows the continuation of trading using existing connectivity parameters in case of unforeseen events with minimal switching time.[52] In consultation with SEBI, stock exchanges and brokers have implemented various measures to address technical glitches in stockbrokers' electronic trading systems, such as the "LAMA (Log Analytics and Monitoring Application) reporting" API, a monitoring platform to overview the IT structure and perform analytics thereof.[53] Additionally, clearing corporations like NSCCL and ICCL[54] have worked on two-way portability to be operated as a "SaaS" (Software as a Service) model to manage unforeseen software failures.[55]

While the synergy of technology and capital markets has unlocked significant benefits, evolving challenges must be addressed. Privacy concerns, cybersecurity risks, and the rising digital divide in the population are some issues that require attention. Nonetheless, regulators have been steadfast in their approach, realising that unlocking the maximum potential from the marriage of technology and capital markets is essential for the overall growth and development of the Indian economy.

Retail Participation in the Capital Market

2.78 The Indian capital markets have seen a surge in retail activity through direct (trading in markets through their accounts) and indirect (through mutual funds) channels in the last few years. The individual investor's share in the equity cash segment turnover was at 35.9 per cent in FY24. The number of demat accounts with both depositories rose from 1,145 lakh in FY23 to 1,514 lakh in FY24. The impact of this influx of individual investors in the market is also reflected in new investor registrations with the exchanges, their share in total traded value, net investments, and ownership in the listed companies. For instance, the registered investor base at NSE has nearly tripled from March 2020 to March 2024 to 9.2 crore as of 31 March 2024, potentially translating into 20 per cent of the Indian households now channelling their household savings into financial markets.

Mutual Funds (MFs): Accelerating the financial savings and retail participation in capital markets

2.79 A rise in retail participation was more substantial and steadier through the indirect channel via mutual funds. FY24 has been a spectacular year for MFs as their AuM of the MFs increased by ₹14 lakh crore (YoY growth of 35 per cent) to ₹53.4 lakh crore at the end of FY24, boosted by mark-to-market (MTM) gains and expansion of the industry. The total number of folios increased from 14.6 crore at the end of FY23 to 17.8 crore at the end of FY24. Barring income/debt-oriented schemes, all categories of MF schemes witnessed net inflows. Inflows into growth/equity-oriented and hybrid schemes accounted for more than 90 per cent of net

[52] https://www.nseindia.com/trade/disaster-recovery-faqs

[53] LAMA reporting: Failure is not an option, ITRS Blog (2023), https://www.itrsgroup.com/blog/new-year-operational-risk

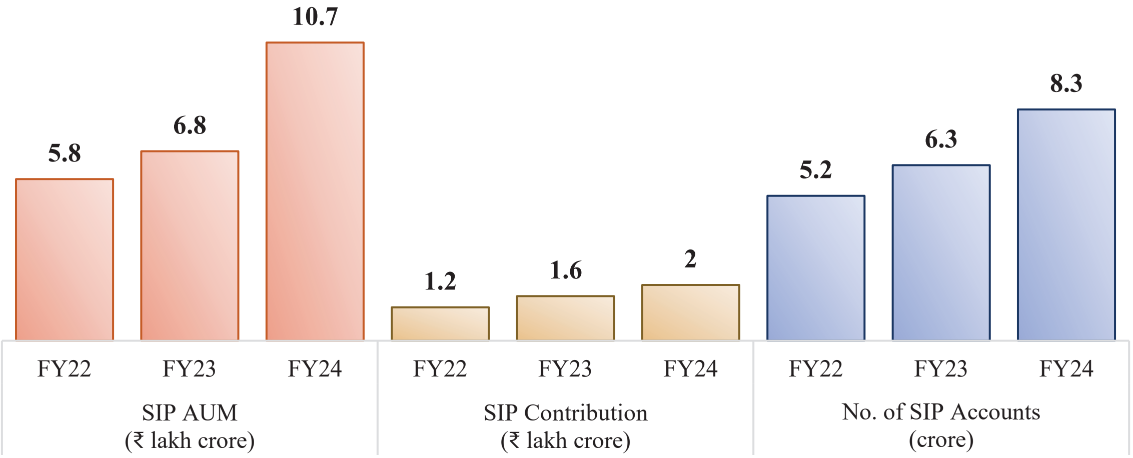
[54] National Securities Clearing Corporation Limited; Indian Clearing Corporation Limited

[55] NSE Clearing Archives dated 29 March, 2023, https://archives.nseindia.com/content/circulars/COM56205.pdf

inflows into MFs. Among the passive schemes, exchange-traded funds (ETFs) (other than gold exchange-traded funds) witnessed a 37 per cent rise in net assets in FY24.

2.80 The MF segment presently has about 8.4 crore systematic investment plan (SIP) accounts[56] through which investors regularly invest in schemes. Annual net SIP flows have doubled in the last three years, from ₹0.96 lakh crore in FY21 to ₹2 lakh crore in FY24. Total SIP AuM is approximately 35 per cent of the AuM of the MF industry for equity-oriented schemes. This has pushed up ownership of MFs in Indian equities to 9.2 per cent as of 31 December 2023, compared to 7.7 per cent as of 31 December 2021.

Chart II.14: SIP investment on a rising trajectory



Note: Outstanding SIP accounts and SIP AuM are reported at the end of each financial year. SIP contribution pertains to yearly gross contribution through SIP accounts.
Source: Association of Mutual Funds in India (AMFI)

2.81 Some of the factors that facilitated the entry of investors in the pandemic period and beyond included seamless technological integration, Government measures towards financial inclusion, growth of digital infrastructure, rapid smartphone penetration, a rise of low-cost brokerages, the pursuit of generating income from alternative sources and lower returns generated by traditional asset classes such as real estate and gold. However, retail investors have cashed in their gains in financial markets and been investing in real assets. It is smart portfolio diversification. A conducive economic environment in the form of lower interest rates, sustained post-COVID-19 recovery, elevated inflation, and a supportive policy backdrop also boosted the retail accumulation of capital market assets. Further, continuous investor awareness programs focusing on the rights and responsibilities of investors have contributed to the continuing growth of individual participation in securities markets. In August 2023, SEBI introduced the Online Dispute Resolution, which combines online conciliation and online arbitration to resolve disputes arising in the securities market. Another significant measure introduced in FY24 was the centralised mechanism for reporting and verification in case of demise of an investor, thereby smoothening the transmission process to the legal heirs. Enhanced Investor

[56] A SIP is a systematic approach to investing in mutual funds that involves allocating a small pre-determined amount of money for investment in the market at regular intervals.

Protection Fund[57] and Settlement Guarantee Fund[58] and shortening of the settlement cycle have improved the perception of safety and security in the Indian markets. Nonetheless, it is essential to ensure that retail investors do not mistake these funds as mechanisms to underwrite their losses and provide a backstop.

2.82 The number of unique tax IDs registered on the NSE rose from 2.7 crore in FY19 to 9.2 crore in FY24. The enhanced participation of retail investors in the Indian capital market is hugely welcome and lends stability to the capital market. It has also enabled retail investors to earn higher returns on their savings. Most of the new retail investors are likely young and may have a higher risk appetite. It is also reflected in the interest that retail investors have shown in derivatives trading, especially expiration-day trading. While derivatives are hedging instruments, they are mostly used as speculative instruments by investors worldwide. India is likely no exception.

2.83 Derivatives trading holds the potential for outsized gains. Thus, it caters to humans' gambling instincts and can augment income if profitable. These considerations are likely driving active retail participation in derivatives trading. However, globally, derivatives trading loses money for the investors, for the most part. Raising investor awareness and continuous financial education is essential to warn them of the low or negative expected returns from derivatives trading. A significant stock correction could see losses that are more considerable for retail investors participating in capital markets through derivatives. Investors' behavioural response would be to feel 'cheated' by unseen more considerable forces. They may not return to capital markets for a long time. That is a loss to them and the economy.

2.84 The financialisation of economies has not ended well, even for advanced economies. The global financial crisis of 2008 is an obvious example. Developing countries face debilitating crises when financial market 'innovations' and growth run ahead of economic growth. The Asian crisis of 1997-98 set back the high-flying economies of the region for a long time. Therefore, India needs to have an orderly and gradual evolution of the financial market.[59]

2.85 All stakeholders – market participants, market infrastructure institutions, regulators, and the Government must ensure that capital markets play their theoretically assigned role of directing savings to their most productive investments. It is not just in the national interest. It is an act of self-interest, too.

Social Stock Exchanges: Leveraging finance from a social stand-point

2.86 Box II.4 discusses the role of the Social Stock Exchange (SSE) in bridging the financing gap by providing alternative fund-raising instruments for achieving socio-development goals.

[57] The Investor Protection Fund compensates the investors to the extent of funds found insufficient in the defaulters' account to meet the admitted value of the claim, subject to a maximum limit of ₹25 lakh per investor per defaulter/expelled member in respect of claims arising on expulsion/declaration of default of members.

[58] The objective of the Settlement Guarantee Fund is to guarantee the settlement of all transactions of the members of the exchange inter-se through the stock exchange.

[59] For further details, please see: Nageswaran, V. & Natarajan, Gulzar. (2019), 'The Rise of Finance: Causes, Consequences and Cures'. Cambridge University Press.

Box II.4: Social Stock Exchanges in India: Making progress

Indian securities markets, over the years, have been characterised by momentous strides in expanding the retail footprint in finance, innovative fund-raising, and regulatory solid scrutiny of stock exchange platforms. To leverage this transparency and rigour of equity markets for social good, in the Union Budget of FY20, the Government proposed to initiate steps towards creating a SSE under the regulatory ambit of SEBI for listing social enterprises and voluntary organisations working for the realisation of a social welfare objective so that they can raise capital as equity as well as, debt in the country.

Need for Social Stock Exchange: The SSE aims to bridge the financing gap by providing alternative fund-raising instruments for achieving socio-development goals. SSE is a separate segment of the existing stock exchange, which can help social enterprises like non-profit organisations (NPOs) and non-government organisations (NGOs) raise funds from the public through the stock exchange mechanism. In this way, SSE is expected to stimulate the ecosystem of outcome-driven philanthropy in India in a transparent and regulated environment. SSE also offers a platform for constructive engagement of NGOs and other enterprises working in the area of social projects related to health, education, livelihood generation, etc., to directly raise funds from the private sector, corporate entities and individuals (including High Net Worth Individuals (HNIs)) and contribute to development goals. With the increasing global appetite for socially responsible investments, SSE bridges this gap and brings the capital markets closer to the masses for meeting various social welfare objectives.

Operationalisation of SSEs: The contributions towards the social sector projects listed on SSE are made through a unique security, known as Zero Coupon, Zero Principal (ZCZP) instrument as the nature of funding is akin to a donation and, as such, does not promise any payment of coupon or return of the principal amount. To scale up this ecosystem, the Government has recently extended tax exemption under section 80G of the Income Tax Act, 1961, to the contributions made through ZCZPs on SSE. Another noteworthy feature of

SSE is that fund-raising on this platform is tied to specific projects undertaken by eligible NPOs. These NPOs are mandated to declare their year-wise milestones that are targeted to be achieved with funds raised from the public. In this regard, the SEBI (Issue of Capital and Disclosure Requirements (ICDR)) Regulations, 2018 identifies broad activities for which these potential projects can be undertaken, in areas such as eradication of hunger, poverty, malnutrition, and inequality; promotion of healthcare, education, livelihood for rural and urban poor; disaster management; and environmental sustainability, among others.

To be listed on SSE, NGOs/NPOs must disclose their past social audit reports, verifying proven expertise and commitment to executing social sector projects. As eligibility criteria, the regulatory framework requires that the NGOs/NPOs have at least 3 years of field experience in executing social sector projects. Further, to ensure accountability of fundraisers to fund-providers, entities raising funds on SEE must disclose detailed information about their social and environmental performance in an Annual Impact Report within 90 days from the end of the financial year, duly audited by a social auditor.[60] Thus, through its rigour, transparency, and scrutiny, the SSE platform ensures that donations reach credible entities, inspiring confidence in the ecosystem and paving the way for its scalability as we advance.

Progress so far: After the rollout of the regulatory framework for SSE by SEBI, National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) obtained SEBI's in-principal approval to set up a separate segment of SSE. As of April 2024, 51 NPOs are registered on the BSE, and 50 (11 undergoing renewal) are registered on the NSE. Nine NPOs have raised funds on SSE, amounting to a total of ₹ 12.4 crore. These projects span social projects in education, livelihood generation, skill development, etc.[61]

Gift IFSC: emerging as a dominant gateway for global capital inflows into india

2.87 The IFSC in GIFT City, Gujarat, is envisaged to be a unique international financial jurisdiction located inside onshore India, set up with a dual objective of onshoring India-centric international financial services business as well as serving as a preferred gateway for channelising global capital flows into and out of the country. Over the last few years, GIFT IFSC has made great strides in achieving both of these objectives. The initiative is a shining example of India’s firm commitment to undertake deep, bold and ambitious financial sector reforms to attract the global financial services business and gradually become a global leader in international finance.

2.88 The uniqueness of the IFSC as a distinct financial jurisdiction emanates from three fundamental factors. First, the IFSC has been designated as a non-resident zone under the Foreign Exchange Management Act, which means that entities set up in the IFSC are outside the capital control restrictions and, therefore, can conduct business in any of the eleven notified foreign currencies.[62] Second, the IFSC has been brought under the regulatory purview of a dedicated and unified financial regulator, i.e. IFSCA (International Financial Services Centres Authority), which has been set up under an Act of Parliament. This regulatory intervention by the Government has significantly bolstered the attractiveness of IFSC among global investors and financial institutions, as they now have to deal with only one Authority for all approvals and licenses. Third, through successive Union Budgets, the Government has provided a separate tax regime for the IFSC, which is at par with what is available in other leading global financial centres. The competitive tax regime has ensured that financial services institutions

[60] A financial auditor audits financial statements and transactions, keeping in mind the objective of issuing an opinion on the state of financial affairs, whereas a social auditor looks at the impact caused on society by the organisation, covering environmental, social and economic aspects. SEBI defines a social auditor as an individual registered with a self-regulatory Organisation (SRO) under the purview of the Institute of Chartered Accounts of India (ICAI).

[61] As per SEBI

[62] US Dollar (USD) Euro (EUR) Japanese Yen (JPY) UK Pound Sterling (GBP) Canadian Dollar (CAD) Australian Dollar (AUD) Swiss Franc (CHF) Hong Kong Dollar (HKD) Singapore Dollar (SGD) UAE Dirham (AED) Russian Ruble (RUB)

operating from IFSC are not at a disadvantage. The contribution of GIFT IFSC in transforming the country's financial industry landscape can be better appreciated by looking at some key business activities in GIFT IFSC.

2.89 **Banking sector:** The Banking ecosystem in GIFT IFSC is rapidly evolving with a healthy mix of foreign and domestic banks, primarily catering to the foreign currency borrowing requirements of Indian corporates and public sector enterprises through external commercial borrowing, trade finance, etc. Transactions under these heads, previously booked from foreign financial centres such as Singapore, Dubai, Hong Kong, etc., are now being booked out of GIFT IFSC. As of March 2024, the total asset size of IFSC Banking Units (IBUs) crossed USD 60 billion, and the cumulative value of transactions undertaken by IBUs crossed USD 795 billion.[63]

2.90 **Funds Industry:** The robust funds industry in GIFT IFSC has a transformative impact in catalysing global capital inflows into India, including the start-up ecosystem. In the last three years, there has been rapid growth in Fund Management Entities (FMEs) and AIFs registered with IFSCA. As of March 2024, the cumulative FMEs and funds registered rose from 39 and 33 as of September 2022 to 114 and 120, respectively, as of March 2024. Previously, the pooling of international capital for investments in India was structured through funds (private equity, venture capital, hedge funds, etc.) set up in offshore jurisdictions. Now, with enabling regulations, a competitive tax regime, and beneficial cost of operations, GIFT IFSC is emerging as a preferred jurisdiction for the pooling of global capital by foreign and Indian fund managers.

2.91 **Aircraft & ship leasing and financing:** The aviation industry in India is on the cusp of unprecedented growth, with a strong order book of more than 1500 + aircrafts placed by Indian airlines and a projected demand for over 2,200 aircrafts by 2042. Currently, most aircraft operated by Indian airlines are leased from offshore lessors that have access to competitive capital costs. The aircraft leasing and financing business, the most profitable segment in the aviation value chain, was entirely residing in foreign jurisdictions. Recognising the immense potential of the aircraft leasing and financing business, IFSCA introduced the enabling leasing framework, and the Government supported the endeavour by providing several tax incentives. In three years, green shoots have been visible in IFSC, with more than 28 aircraft lessors already registered, which have leased more than 120 + aviation assets, including commercial aircraft, helicopters, aircraft engines and ground support equipment. Interestingly, Air India has also commenced leasing its wide-bodies aircraft from the IFSC Zone.

2.92 Considering the critical role of the maritime and shipping industry, the Government and IFSCA have taken significant steps to develop a robust ship leasing and financing ecosystem in GIFT IFSC. The initial focus is to bring back Indian shipping companies who are leasing/ owning ships out of foreign jurisdiction. With an enabling regulatory framework, the ship leasing ecosystem is gaining traction. As of 31 March 2024, the number of ship leasing companies registered with IFSCA has risen to 11, underscoring the financial centre's rising appeal for maritime business. Furthermore, these companies have acquired and leased four

[63] Data sourced from IFSC GIFT City

assets from GIFT IFSC. Going forward, IFSCA intends to work with IFSC Banking Units (IBUs) to develop a vibrant ship and aircraft financing ecosystem and contribute towards increasing Indian ownership of assets.

2.93 **Foreign universities initiative:** The IFSC, being an offshore jurisdiction, is also uniquely positioned to become an 'international higher education hub' by attracting top-quality global universities keenly exploring India due to its talent and demographic profile. This opportunity was outlined in the Union Budget FY23, wherein it was stated that 'World *Class Foreign Universities and Institutions will be allowed in the GIFT City to offer courses in Financial Management, Fintech, Science, Technology, Engineering and Mathematics, free from domestic regulations, except those by the IFSCA to facilitate the availability of high-end human resources for financial services and technology*'. In this endeavour, IFSCA achieved a significant milestone in FY24 when Deakin University from Australia became the first foreign university to be granted final registration for their International Branch Campus in GIFT IFSC under IFSCA (Setting up and operation of International Branch Campus and Offshore Education Centre) Regulation, 2022. Additionally, the University of Wollongong from Australia became the second foreign university to receive in-principal approval for their International Branch Campus in GIFT IFSC. The entry of two foreign universities in GIFT IFSC has paved the way for other globally reputed universities to look at this opportunity and contribute to the rise of an educated and skilled India.

2.94 There are several ongoing reforms to establish IFSC as a reputed international financial centre towards achieving the dual mandate of development and regulation of financial services. IFSCA is in the process of implementing robust regulatory and supervisory systems backed by best-in-class technology. The announcements made in the Union Budget FY24, such as a single window IT system for registrations and delegating powers under the SEZ Act to IFSCA to avoid dual regulations, will enhance the ease of doing business. The IFSC is expected to emerge as a preferred gateway for global capital flows into and out of the country.

Developments in the insurance sector

Moderation in global insurance markets

2.95 Global economic slowdown and inflation have raised challenges for insurers. The cost of capital is rising with more robust investment returns. Reserve adequacy has emerged as a critical consideration as a prolonged period of favourable development wanes due to the current and recent shocks of high inflation and the COVID-19 pandemic. Despite having a large buffer, the pace of industry reserve releases has slowed. In the existing environment, many uncertainties prevail, such as delayed settlements, which emerge as a more significant problem in periods of high economic and social inflation. The shift of inflation from goods to services has impacted liability exposures. In the future, lower claims once disinflation sets in and higher returns on interest rate-sensitive investments are expected to support profitability.

2.96 Considering the abovementioned factors, global insurance markets have witnessed a contraction in 2022 compared to the previous year. As per the Swiss Re Institute report on World Insurance 2023[64], total global insurance premiums contracted by 1.1 per cent in real terms in 2022, compared to a growth of 3.4 per cent in 2021. However, the non-life insurance sector witnessed an increase of 0.5 per cent in 2022, though lower than the 2.6 per cent growth registered in 2021, driven by rate hardening in commercial lines in developed markets. In the life insurance segment, global premiums contracted by 3.1 per cent in 2022, compared to a growth of 4.5 per cent in 2021.

India is poised to emerge as one of the fastest-growing insurance markets in the coming decade

2.97 Economic growth, an expanding middle class, innovation, and regulatory support have driven insurance market growth in India. In FY23, premium growth moderated slightly compared to the previous year, reflecting still-in-process adjustments to the post-COVID-19 era. Overall insurance penetration[65] in India moderated slightly to 4 per cent in FY23, from 4.2 per cent in FY22. During the same period, insurance penetration in the life-insurance segment declined from 3.2 per cent in FY22 to 3 per cent in FY23, while it remained flat at 1 per cent for the non-life insurance segment. Overall insurance density[66] increased from USD 91 in FY22 to USD 92 in FY23. In the life insurance segment, it rose from USD 69 in FY22 to USD 70 in FY23 and remained stable in the non-life insurance segment.[67]

2.98 As per the Swiss Re Institute Report,[68] Life premium growth in India is estimated to slow to 4.1 per cent in FY23 (higher than the historical average of 3.2 per cent during 2012-2021) from 5.9 per cent in FY22 as memories (i.e., risk awareness) of the pandemic faded and a recent change in tax norms for high-ticket policies[69] weighed on new premium growth. Owing to these factors, new business premiums, after growing by 40 per cent in the first quarter of FY22, contracted in the fourth quarter (7 per cent). The momentum continued in FY23 as well, with new business premiums in the second quarter declining by 21.2 per cent, mainly due to a contraction in the group insurance business.

Status of Non-Life Insurance segment

2.99 Non-life premium growth moderated slightly from 9 per cent in FY22 to an estimated 7.7 per cent in FY23 (lower than the historical average of 8 per cent during 2012-2021) as the market stabilised after the pandemic. Growth in almost all lines of business slowed last year

[64] Swiss Re Institute Report, World Insurance Market 2023, https://t.ly/64ENQ

[65] Insurance penetration refers to the ratio of the insurance premiums written in a particular year to GDP

[66] Insurance density refers to the ratio of insurance premium to population, i.e., insurance premium per capita and is measured in US Dollar.

[67] Swiss Re Institute Report, 'India's Insurance Market: Growing Fast with Ample Scope to Build Resilience', https://t.ly/tagPh

[68] Ibid

[69] Under this regulation, any proceeds from a life insurance policy with an annual premium exceeding ₹5 lakh are subject to taxation. As a result, section 10(10) of the Income Tax Act, previously offering exemptions, no longer applies to policies with premiums surpassing this threshold.

as the industry stabilised after the pandemic. The sector faces headwinds such as economic slowdown, high interest rates, and elevated retail and medical inflation.

2.100 Health accounts for around 35 per cent of sector premiums written in FY23. With an estimated increase of 11 per cent in premiums, health saw the fastest growth amongst all non-life lines in FY23. Increased health awareness, supportive government policies, rising medical costs and innovations in Insurtech have supported this growth. Although price and income constraints may limit demand for the lower income groups, the expanding middle class and increased discretionary spending are expected to support overall growth. Further, to provide health insurance to low-income households, Ayushman Bharat Pradhan Mantri Jan Arogya Yojana (AB-PMJAY) and State government extension schemes are in place. Recently, AB-PMJAY achieved a milestone of generating 34.2 crore Ayushman cards across India, with 49.3 per cent of them held by females. In the medium term, health premiums are projected to grow by 9.7 per cent annually in 2024-28, with regulatory initiatives to improve the attractiveness of insurance offering some support.

2.101 Agriculture insurance is another line of business, accounting for around 12 per cent of the non-life insurance market. The agriculture insurance is estimated to register a flat growth in FY23 due to a sharp decline in premium rates in the Kharif cropping season. The decline was more than offset by increased insured land area and farmer enrolments during the season. Agriculture premiums will likely rise from 2024 onwards, with an average real premium growth of 2.5 per cent over the medium term, supported by improvements in insurance infrastructure such as mobile applications and remote sensing for crop loss monitoring. The Government has launched various initiatives to address current concerns around crop insurance. These include the launch of new technological initiatives such as the YES-Tech Manual, WINDS portal, and enrolment app AIDE/Sahayak to assess crop damage via satellite-based advanced technologies, and with door-to-door enrolment initiatives making cover more accessible.

2.102 The Government and Insurance Regulatory and Development Authority of India (IRDAI) have taken several steps to support industry growth. Paramount among these is the mission "Insurance for all by 2047", launched in November 2022, to ensure that every citizen and enterprise has appropriate insurance cover/solution. Three major initiatives, Bima Sugam,[70] Bima Vahak,[71] and Bima Vistaar[72] are expected to be launched, aiming to raise insurance penetration, particularly in semi-urban areas, rural towns, and villages.

2.103 The IRDAI approved amendments to the reinsurance regulations to position India as a global reinsurance hub. Fundamental changes include reducing Foreign Reinsurance Branches' (FRB) minimum capital requirement to USD 6.1 million from USD 12.2 million and streamlining the regulator's order of preference of cession by Indian insurers to reinsurers to

[70] "Bima Sugam" is an online portal to facilitate the buying of insurance, portability facilities, the ability to change insurance agents and the settling of life, motor and health claims directly with insurers

[71] "Bima Vahak" is a women-centric insurance distribution channel

[72] "Bima Vistaar" is a social safety net accessible to all through the Bima Sugam platform

four from six levels. Reinsurance formats have been simplified, and the International Financial Service Centre Insurance Offices' (IIOs) framework has been aligned with that of the IFSCA rules for better competitiveness.

2.104 A comprehensive regulatory review has been undertaken, transitioning from a rule-based approach to a principle-based architecture while establishing a resilient and robust risk management framework. Streamlining the operations, 167 circulars and 82 returns have been repealed, while 78 regulations have been amended, consolidated, and reduced to 28. The regulatory clearance processes for insurance products have also been replaced from the erstwhile requirement of prior approval under the '*File and Use*' regime, with all the products under the general and health insurance and the majority of the life insurance products being required to follow '*Use and File*' procedures which facilitate insurers to launch the products quickly considering the market dynamics.

2.105 Various regulatory stipulations have also been removed for product offerings under all the segments, focusing on the health insurance segment to provide enhanced coverage and choice to customers. Further, to empower policyholders with a deeper understanding of their insurance coverage, issuance of a concise *Customer Information Sheet* (CIS) to the policyholders has been made compulsory for all types of insurance policies.

2.106 Further, to make the industry future-ready and align with global standards, significant progress has been made towards the implementation of the Risk-Based Supervisory Framework, Risk-Based Capital Framework, and International Financial Reporting Standards. The IRDAI facilitates coordinated efforts between insurers and state governments through state insurance plans to take insurance services to the last mile and even the remotest parts of the country.

2.107 These reforms and sustained economic growth are expected to facilitate the continued development and advancement of the insurance sector supported by robust economic growth, an expanding middle class, innovation, and strong policy support. There are favourable projections for the Indian Insurance market. The Swiss-Re Institute January 2024 report[73] projected that over the next five years (2024-28), total insurance premiums in India will grow by 7.1 per cent in real terms, well above the global (2.4 per cent), emerging economies (5.1 per cent) and advanced economies (1.7 per cent) market averages. At this rate, India will have the fastest-growing insurance sector amongst the G20 countries. Insurance penetration as a per cent of GDP is projected to grow from 3.8 per cent in FY23 to 4.3 per cent by FY35. The growth in life business (premiums up 6.7 per cent in 2024-28) is likely to be supported by rising demand for term life cover by the middle class, the country's young population and increasing industry adoption of Insurtech. Non-life premiums are projected to grow at an annual average of 8.3 per cent during 2024-28, driven by economic growth, improvement in distribution channels, government support and a favourable regulatory environment. Further, over the next

[73] https://tinyurl.com/mryvwj9m

decade (2024-34), total premiums are expected to more than double (inflation-adjusted), and insurance penetration will increase from 3.8 per cent presently to 4.5 per cent in 2034.

2.108 For the anticipated rise in insurance penetration to materialise, the industry has to become more customer-friendly. According to the Annual Report of IRDAI for FY23[74], the centralised grievance portal received over two lakhs of complaints during the year. If the Life Insurance Corporation of India is excluded, over 50 per cent of the complaints against life insurers were about unfair business practices, a euphemism for mis-selling. Further, 66 per cent of the complaints against general insurers were about claims, including delayed and denied settlements. The industry has to think and work for the long term. Insurance penetration will not rise. Data for FY23 showed a decline in insurance penetration. When it comes to financial products, globally, 'soft-touch' regulations have seldom worked over a sustained period in delivering customer satisfaction and value for money.[75] Globally, the private financial sector has repeatedly shown itself to be adept at selective or misinterpretation of principles-based regulations to its benefit.

Developments in the pension sector

2.109 The demographic structure of most countries is changing significantly as birth rates continue to fall. This development has significant consequences for pay-as-you-go pension arrangements, which rely on the next generation of taxpayers to fund the pensions paid to previous generations. In the recent past, the re-emergence of inflation has also damaged the community's confidence in the ability of pension programs to deliver adequate retirement benefits over the longer term. Although inflation has declined in some economies, its persistence has highlighted this risk to current and future retirees. At the same time, there is an ongoing global shift away from defined benefit (DB) to defined contribution (DC) arrangements, in which individuals carry all risks relating to investment returns, inflation and, often, longevity. Very few systems have solved the dilemma of moving from an individual-based DC accumulation system to a post-retirement system that provides adequate and secure income to retirees while providing them the same flexibility available during their working years.

2.110 An ongoing challenge facing many pension systems is the inclusion of gig workers and those in the informal labour market. In many economies, the labour market is fracturing; therefore, the stable or structured employer-employee relationship is disappearing. In such circumstances, pension arrangements must become more individually focused and less reliant on third parties.[76]

[74] https://tinyurl.com/98vs72dc

[75] 'Insurance industry needs a regulatory shake-up', Business Line, 10th February 2024 (https://www.thehindubusinessline.com/opinion/insurance-industry-needs-a-regulatory-shake-up/article67829954.ece)

[76] International Labour Organisation, 'Non-Standard Employment Around the World: Understanding challenges, shaping prospects', https://tinyurl.com/3uah4a4n

Performance of India's Pension Sector

2.111 According to the 15th Annual Mercer CFA Institute Global Pension Index (MCGPI)[77], India's overall global pension index value improved from 44.5 in 2022 to 45.9 in 2023, primarily due to an improvement in adequacy and sustainability sub-indices. India's pension system comprises an earnings-related employee pension scheme, a defined contribution Employee Provident Fund (EPF) and supplementary employer-managed pension schemes that are essentially by way of DC. Changes in workforce dynamics, employment, and family patterns have brought formal sources of retirement to the forefront. While there is improvement in the net pension replacement rate and participation in private pension plans, which is reflected in the value of adequacy and sustainability sub-indices, the coverage of the Indian workforce under private pension plans is yet to be enhanced.[78] The Government has launched various schemes as part of the universal social security programme to benefit the unorganised sector.

2.112 India's pension sector has expanded since the introduction of the National Pension Scheme (NPS) and, more recently, the Atal Pension Yojana (APY). The total number of subscribers stood at 735.6 lakh as of March 2024, registering a YoY growth of 18 per cent from 623.6 lakh as of March 2023. The total number of APY subscribers (including its earlier version, NPS Lite) increased from 501.2 lakh as of March 2023 to 588.4 lakh as of March 2024. APY subscribers account for around 80 per cent of the pension subscriber base.[79]

2.113 Disaggregated data of the Pension Fund Regulatory and Development Authority of India (PFRDA) shows that APY subscribers have witnessed an improvement in gender mix, with female subscriber share rising from 37.2 per cent in FY17 to 48.5 per cent in FY23. The age mix is increasing also in favour of the younger cohort in the age group of 18-25, from a share of 35 per cent in FY17 to 46.7 per cent in FY23 However, the bulks, about 92 per cent, of APY accounts are for a pension amount of ₹1,000 per month, followed by 4.7 per cent for ₹5,000. The overwhelming share of ₹1,000 pension in APY could be due to several factors, the predominant cause being that the target population is low-income households where day-to-day consumption expenditure takes precedence over savings.[80]

2.114 The population's pension coverage under these two schemes (NPS & APY) as a share of the total population has increased from 1.2 per cent in FY17 to 5.3 per cent in FY24. AuM under these schemes as a proportion of GDP has risen from 1.1 per cent in FY17 to 4 per cent in FY24.

Outlook for the Pension Sector

2.115 In the future, NPS (private sector) is poised to expand rapidly as an increasing number of corporate employees and relatively better-off households, for example, self-employed and

[77] The Mercer CFA Institute Global Pension Index benchmarks 47 retirement income systems around the world, highlighting challenges and opportunities within each. The index is made up of three sub-indices, adequacy, sustainability, and integrity that measure each retirement income system against more than 50 indicators

[78] Presently, 6 per cent of the Indian workforce is covered under private pension plans, as per the 15th Annual MCGPI.

[79] https://www.pfrda.org.in/

[80] Monthly Pension Bulletins of PFRDA, https://www.pfrda.org.in

professionals such as doctors, lawyers, and small business owners, see the merit of joining NPS. There is a potential for NPS in rural areas for larger farmers, traders, and those with lumpy incomes, as it does not require a standard monthly contribution.

2.116 There is a tremendous scope for growth as India's per capita income rises further and transitions to a high-middle-income country. India's demographic structure, with a more significant proportion of younger people, favours a phase of accumulation. Since life expectancy is inching up, the need for a steady income stream is also increasing to mitigate old-age poverty. Further, as the traditional family support system changes with growing urbanisation, there is even a greater necessity for an independent source of income in old age.

2.117 Financial literacy becomes essential for people to reap the benefits of the formal financial sector. There are many facets to pension literacy; women in the family must have a pension account given their higher longevity; it is prudent to empower young adults, particularly students, with a pension account so that they imbibe the financial discipline of long-term saving.

2.118 Financial inclusion and empowerment will only be complete with each family member's pension account. In this direction, given the nature of the pension product where the payoff is not immediate, it needs a nudge by all concerned, the employers, intermediaries, the Government, and the pension regulator, to induce people, particularly young adults, to join a pension scheme. There is immense merit in joining young as, with small contributions, a sizeable corpus could be accumulated given the power of compounding, providing substantial steady income in one's post-working life.

Mechanisms to ensure regulatory coordination and overall financial stability

2.119 The financial system's stability is paramount for sustainable economic growth and prosperity. A financially stable system should be robust to macroeconomic disturbances. It should withstand unforeseen shocks so that there is a high degree of confidence that it will continue to meet its contractual obligations. Financial stability means not only an absence of actual crisis but also the ability of the system to limit and manage imbalances before they assume a magnitude that threatens itself or the economic processes.

2.120 The role of the Government in ensuring financial stability is multifaceted and crucial. Governments worldwide employ various policies, regulations, and measures to safeguard the integrity and smooth functioning of the financial sector. It would also be essential to assess how financial instability interacts with the real economy to either amplify or moderate the effects of initial shocks. Thus, regulators responsible for oversight of different financial institutions must interact and cooperate closely among themselves and with those responsible for the stability of prices and the real economy.

2.121 In the Indian context, the Financial Sector Development Council (FSDC)[81] is a forum that facilitates interaction among various financial sector regulators. It is mandated to deal with a wide range of issues relating to financial stability, financial sector development, inter-regulatory coordination, financial literacy and financial inclusion, macro-prudential supervision of the economy, including the functioning of large financial conglomerates, coordinating India's international interface with financial sector bodies (like Financial Action Task Force (FATF), Financial Stability Board (FSB)) and any other matter relating to the financial sector stability and development referred by a Member/Chairperson and considered prudent by the Council.

2.122 Under the FSDC, the FSDC sub-committee (FSDC-SC) is a forum chaired by the RBI Governor which deliberate on agenda items proposed by any of the members along with supportive actions required. Further, the RBI promotes the financial sector's resilience by regulating financial institutions, monitoring systemic risks, and implementing monetary policy. The collective assessment of the risks to financial stability and the strength of the Indian financial system is undertaken and reported in the bi-annual Financial Stability Report (FSR) published by RBI since March 2010.[82]

Financial Sector Assessment Program (FSAP) for India

2.123 FSAP is the quinquennial exercise jointly conducted by the IMF and the World Bank in countries having 'systemically important' financial sectors. FSAP involves a comprehensive and in-depth analysis of a country's financial industry to assess financial stability and financial sector development. India underwent its first FSAP exercise in 2011-12 and the second one in 2017, after which IMF-World Bank published its reports, including the Financial System Stability Assessment Report (FSSA) and Financial Sector Assessment (FSA) report. The third FSAP exercise for India is underway for 2023-24. The FSSA and FSA reports will be published by February 2025.FSB publishes its annual report on the Implementation and effects of the G20 financial regulatory reforms, mentioning implementation status across various jurisdictions. The colour-coded template in the report[83] highlights the extent of sectoral implementation of FSB Principles and Standards. The monitored priority areas include (i)Basel-III reforms, (ii) Compensation, (iii) Over-the-Counter (OTC) derivatives, (iv)Resolution, and (v) Non-Banking Financial Intermediation (NBFI).

2.124 Implementation of Basel III Reforms[84] has supported resiliency in both the domestic and global banking sectors. Under Basel III pillars reforms, India is largely compliant as it has laid down provisions for Net Stable Funding Ratio, liquidity coverage ratio, requirements for

[81] The Minister of Finance chairs the FSDC. Members are MoS (Finance), heads of all other financial sector regulatory bodies (e.g., RBI, SEBI, IRDAI, PFRDA, IFSCA), Secretaries of the departments of (i) Economic Affairs, (ii) Expenditure, (iii) Financial Services, (iv) Revenue, (v) Ministry of Corporate Affairs and (v) Ministry of Electronics and Information Technology and the Chief Economic Adviser to the Ministry of Finance. The Financial Stability and Cyber Security Division of the Department of Economic Affairs, Ministry of Finance serves as the Secretariat of the Council, and the Division Head of the Division is the Member Secretary of the Council

[82] RBI Financial Stability Report June 2024,

[83] 2023 Financial Stability Board (FSB) Annual Report, 11 October 2023, 'Promoting Global Financial Stability', https://www.fsb.org/wp-content/uploads/P111023.pdf

[84] FSB classifies implementation under three heads where a jurisdiction has published and implemented final rule, has published rule but not implemented and has not published draft regulation.

Systematically Important Banks, and supervisory framework for measuring and controlling bank's large exposures .in line with international standards. India is also in the process of implementing the other two requirements under Basel III, that is, revised leverage ratio requirements and risk-based capital framework.

2.125 For the compensation pillar, India already has in place Standards for Sound Compensation Practices (Principles and Standards) for significant banks, insurers, and asset managers in India.

2.126 Under the OTC derivatives segment, India made significant progress in 2023 from the 2022 FSB assessment, as more than 90 per cent of the OTC derivatives now follow trade reporting, central clearing and platform trading requirements under FSB principles. The fourth parameter under the OTC pillar, that is, margin requirements concerning OTC derivatives, is currently under implementation.

2.127 Enhancing the resilience of NBFI is an important priority of FSB, which under key reforms area is bucketed under Money Market Mutual Funds, Securitisation and Securities Financing Transactions (SFT) requirements. India is the only jurisdiction among 24 reported by FSB in total compliance with SFT requirements including minimum regulatory standards for collateral valuation and management, numerical haircut floors on bank-to-non-bank transactions, etc. India has actively undertaken securitisation and MMFs reforms in line with FSB principles.

Financial System Stress Indicator

2.128 The RBI, in the 26th issue of its FSR[85], attempted to compile a comprehensive indicator called the financial system stress indicator (FSSI)[86] to monitor the aggregate stress level in the Indian financial system. FSSI aims to (a) help identify periods of stress, (b) assess the intensity and duration of stress in the financial system, and (c) gauge the ability of financial markets and intermediaries to withstand shocks and imbalances.

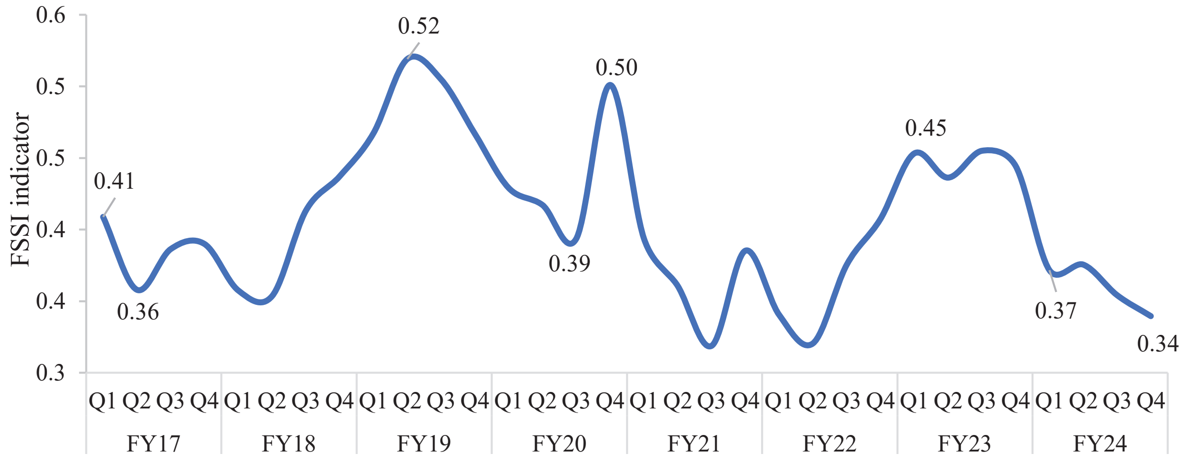
2.129 The latest FSR of June 2024 shows that FSSI indicated a gradual easing of stress during H2 of FY24. The decline in stress indicators has been broad-based, except for the NBFC and money market segments. The decline in government debt market stress was the primary contributor to the improvement in the overall FSSI, aided by a fall in long-term yields as well as volatility and higher net foreign portfolio debt inflows. Meanwhile, declining volatility and rangebound movement in the exchange rate reduced stress levels in the foreign exchange market. Money market stress indicators inched up as tight liquidity in the banking system led to higher interest rates on money market instruments (e.g., Commercial Papers and Certificate of Deposits). The banking system stress indicator remained subdued, supported by improving soundness. The real

[85] 26th issue of the RBI Financial Stability Report, December 2022, page 56, https://t.ly/o_CZb.

[86] The FSSI features risk factors about five financial market segments-equity, foreign exchange, money, government debt and corporate debt markets and three groups of financial intermediary segments, namely, banks, NBFCs and AMC-MFs. It also features a real sector component encompassing select real sector variables that have a bearing on financial stability due to their strong interlinkages with the financial sector. For more details, refer: https://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=57005

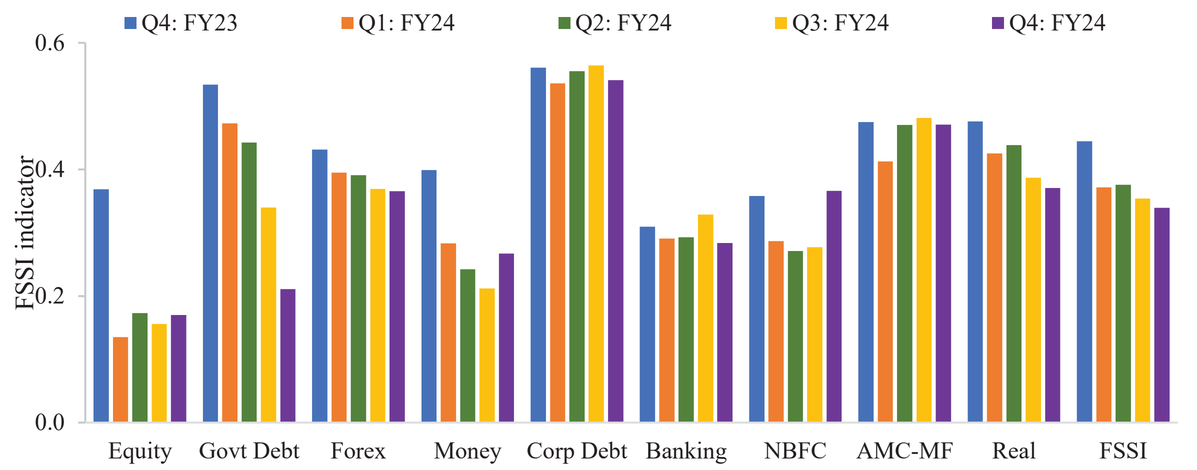
sector stress indicator moderated further on the back of sound macroeconomic fundamentals. Stress indicators for the NBFC sector rose as their capital ratios dipped and spreads on their borrowing costs increased.

Chart II.15: Easing of stress in the Indian financial system reflected in FSSI



Source: Chapter I: Macrofinancial Risks, RBI Financial Stability Report, June 2024

Chart II.16: Broad-based decline in stress levels across financial sectors



Source: Chapter I: Macrofinancial Risks, RBI Financial Stability Report, June 2024

ASSESSMENT AND OUTLOOK

2.130 On most counts, India's financial industry has progressed over time. Domestic credit to the private sector as a per cent of GDP rose from 50.6 per cent in 2010 to 54.7 per cent in 2021. Gross and Net NPAs of SCBs have been declining over time, accompanied by an improvement in CRAR, RoA and RoE. Despite heightened geopolitical uncertainty, India's stock markets have been stable.

2.131 Even as banks, non-banks and corporates battled balance-sheet excesses, the consequences of the credit boom of the first decade of the new millennium and the inevitable bust that followed in the second decade, the broad industry kept advancing the cause of financial inclusion and financial deepening. As India embarks on the vision to become a developed country by 2047, it is imperative that financial intermediation costs decline globally. India has made significant strides in this regard, which may be one reason for its resilient post-Covid economic recovery. However, much work could be done to make it a global financial leader.

2.132 The outlook for India's financial sector appears bright. The vision of Viksit Bharat by 2047 is indeed an opportunity for a prosperous society, robust financial services sector, strong public finances, and economic sovereignty. The elements of a robust financial services sector include a highly competitive and viable banking sector, universal access to banking and other financial services for all citizens, lowest intermediation costs, efficient and quick access to credit and equity funding for small businesses, highly liquid, efficient, and well-regulated stock, bond, and commodity markets. India's financial sector needs to support capital formation and promote trade, business, and investments in MSMEs, enabling them to scale It also needs to provide insurance protection and retirement security to all citizens. The share of insurance and pension fund assets in GDP stands at 19 per cent and 5 per cent, respectively, in India, compared to a high of 52 per cent and 122 per cent in the USA and 112 per cent and 80 per cent in the UK, leaning scope for further improvements.

2.133 The next big step in the coming years is likely to be towards Artificial Intelligence/Machine Learning (AI/ML), Decentralised Finance, Internet of Things (IoT), etc., which have a vast potential to disrupt the digital payments ecosystem. Further, the vision is for India to evolve as a 'fintech nation' with the highest number of fintech firms and the highest fintech adoption rate by incumbents fuelled by digital public infrastructure. An approach should be evolved for common user data, e.g. KYC, across Regulators. In the medium term, efforts should be made to move towards data-based lending instead of judgment-based lending, especially for small businesses. In this regard, there is a need for continuous review to identify regulatory gaps/overlaps and benchmark them with the best global practices. Financial sector firms – public or privately owned – must become customer-centric. Without that, most quantitative metrics will remain elusive.

2.134 The Indian financial sector is at a turnpike moment. The dominance of banking support to credit is being reduced, and the role of capital markets is rising. For a country that aspires to be a developed nation by 2047, this is a long-awaited and welcome development. Being reliant on and exposed to the capital market, however, comes with its challenges and trade-offs. As India's financial sector undergoes this critical transformation, it must also brace for likely vulnerabilities and prepare itself with regulatory and government policy levers to intervene and hedge, as required.

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