Financial RegTech Newsletter

May 2021

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01 RBI's initiatives and measures to deal with the impact of COVID-19

The impact of COVID-19 continues to be felt by small businesses and consumers in 2021 and may well extend into 2022.

The Reserve Bank of India (RBI) has announced several timely measures to address this unprecedented situation. This edition of PwC's Financial RegTech newsletter will unpack the RBI's response to the second wave.

Introduction

The main goal of the Central Bank is to control and stabilise inflation and financial markets, lower unemployment, and promote steady growth in the national output. It is widely accepted that interest rates are the key parameter which can help control these goals through three major instruments: open market transactions, increasing/decreasing the repo rate and maintaining/depleting foreign reserves. In recent times, the RBI has had to closely monitor consumer sentiments and grievances. For example, credit card frauds and fee structures of banks have forced the RBI to intervene and implement significant measures and even educate consumers through ads, which is a very recent development.

In his speech on 5 May 2021, the RBI Governor, Shaktikanta Das, stated that "the immediate objective is to preserve human life and restore livelihoods through all means possible".[1] In the wake of the considerable loss of life, burden of hospitalisation, business shutdowns and job cuts that the nation has seen due to the pandemic, the governor has called for unconventional and creative ways to structure future policy. At the same time, he has emphasised the need to focus on growth objectives with macroeconomic and financial stability.

- Global merchandise trade showed a growing trend of 5.4% YoY in February 2021.
- Average electricity generation was up YoY by 40% in April 2021.
- Rail freight saw 76% growth YoY in April this year.
- The Purchasing Managers' Index (PMI) (considered as the prevailing direction of economic trends in the manufacturing sector) almost remained constant MoM in April.
- Foreign exchange reserves stood at USD 588 billion as of April 2021.

1 Governor's statement on 5 May 2021

Setting the context

With the government's fiscal strength solidified after the first wave of COVID-19 and with infrastructure seeing strong recovery and consumption demand holding up, there was a sense of optimism as companies were more prepared than before, financially, and structurally, to execute strategic goals.

Through his speech, the governor set the context for the various measures taken. The global economic situation, which was uncertain with high downside risks, showed signs of recovery. The IMF indicated a global growth of 6.0% from 5.5% on the assumption of availability of vaccines by 2021 across advanced economies and key emerging economies, which also buoyed global financial markets. The consumer price index (CPI) remained controlled, yet above desired levels due to global food and commodity prices. Domestically, the strong agricultural sector was resilient and poised to provide food security, employment opportunities and effectively manage supply-chain logistics.

The high frequency indicators around the areas of aggregate demand for consumer goods, revenue from infrastructure and automobiles showed mixed signals, prompting continuous monitoring of the situation. The strong foreign exchange reserves can offset anomalies in the global market. Overall, there was a sense of cautious optimism with mixed signals from the economy with the onset of the second wave.

Policy response to the second wave

The second wave saw higher death rates, including a spike in the younger age group, higher recovery periods, a longer than usual post-recovery period, lack of hospital beds and a shortage of medicines/medical equipment. These developments led to a targeted policy towards frontline workers and the common man. The policy measures taken have been described below.

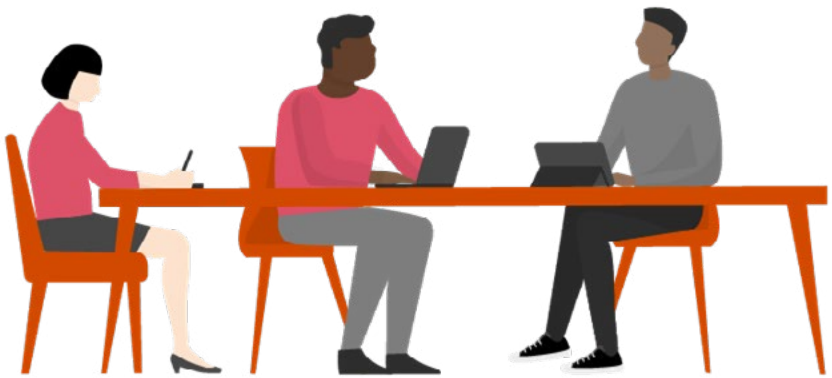
The healthcare supply chain has been provided with much-needed liquidity of INR 50,000 lakh crore for a three-year period and classified as a priority sector (till 31 March 2022). This includes a wide range of entities, including vaccine manufacturers; importers/suppliers of vaccines and priority medical devices; hospitals/dispensaries; pathology labs; manufactures and suppliers of oxygen and ventilators; importers of vaccines and COVID-related drugs; logistics firms and patients for treatment. Accordingly, banks are expected to open a COVID loan book. They are also being incentivised to provide a loan facility by parking excess liquidity with the RBI at 25 basis points below the repo rate, up to the size of the COVID loan book.

Small finance banks (SFBs) have been handed a major role in providing small businesses, MSMEs and the unorganised sectors with a liquidity of INR 10,000 lakh crore till 31 October 2021. Furthermore, SFBs can classify loans to microfinance institutions (MFIs) with an asset size of up to INR 500 crore under the priority sector till 31 March 2022. Banks have been encouraged to lend to micro, small and medium enterprises (MSMEs) by way of not having to maintain the cash reserve ratio (CRR) until 31 December 2021. Small businesses, MSMEs and individuals with aggregate exposure up to INR 25 crore, who have not availed restructuring and are classified as standard in the banking books, may avail restructuring till 30 September 2021.

If restructuring has already been availed, the residual tenor of the moratorium has been extended for two years. Banks can also review working capital limits, cycles, margins, etc., as a one-time measure due to the inherent risk involved.

In an attempt to make KYC norms business and user friendly, the video-based customer identification process (V-CIP) has been introduced for new and existing customers for updates, along with conversion of limited KYC accounts to full KYC accounts based on Aadhar e-authentication, use of a centralised KYC identifier for document submissions and promotion of the use of digital channels for updating KYC details. No punitive action will be taken for customers whose KYC is due/pending until 31 December 2021 (except for some special cases).

Banks are permitted to use the countercyclical buffers maintained as part of capital requirements as of 31 December 2020 to account for non-performing assets (NPA) provisioning (with board approval). Overdraft (OD) facilities availed by state governments have been allowed for 50 days in a quarter (from 36) and 21 consecutive days in a month (from 14) to better manage the fiscal situation.



Conclusion

The RBI’s measures address liquidity issues faced by small businesses, the common man and state governments. However, it could have also addressed the issues of rising fuel prices, unemployment and underemployment and the outlook for the near future. Restructuring of loans and extension of moratorium periods will provide some much-required breathing room to small businesses and individuals. However, there was a need for measures that would have a more direct impact on unemployment. For example, in the US, small business administration (SBA) loans were provided to keep employees without wage cuts for eight consecutive weeks and/or pay utility bills for the concern. The surplus noted in merchandise trading may be seen as aversion or inability to spend by the consumer and may normalise over the long-term.

Priority lending will help the frontline warriors and impacted communities to better manage the current situation. Relaxation of KYC norms eliminates some bureaucratic red tape and may have been made done with an eye on the future. In short, the slew of measures taken by the RBI are likely to have a positive impact, with a greater focus on injecting liquidity into the system to counteract the potential effects of a third wave of the pandemic.

02 Regulatory news

Reserve Bank of India (RBI) on Resolution Framework 2.0 – Resolution of Covid-19 related stress of Micro, Small and Medium Enterprises (MSMEs)

In reference to the circular dated 6 August 2020 on restructuring of advances to the MSME borrowers, on 5 May 202, it has been decided to extend the above facility without downgrade in asset classification subject to conditions mentioned in the circular.

The asset classification of borrowers will be retained as such and the accounts which have slipped to the NPA category between 1 April 2021 and the date of implementation may be upgraded as ‘standard asset’, as on the date of implementation of the restructuring plan.

As a one-time measure, borrowers’ accounts which were restructured based on the MSME restructuring circular and lending institutions can review the working capital sanctioned limits and/or drawing power based on a reassessment of the working capital cycle, reduction of margins, etc. Decisions regarding the above shall be taken by lending institutions by 30 September 2021. The notification can be accessed **here.**

RBI notification on customer due diligence for transactions in virtual currencies (VCs)

In attention to the media reports claiming certain banks/regulated entities have cautioned their customers against dealing in VCs by referring to a circular, the references are not in order and are set aside by the Hon’ble Supreme Court on 4 March 2021 and cannot be quoted from.

Banks and other entities may continue to carry out customer due diligence in line with regulations governing standards for Know Your Customer (KYC), Anti-Money Laundering (AML), Combating of Financing of Terrorism (CFT), the Prevention of Money Laundering Act, (PMLA) and the Foreign Exchange Management Act (FEMA) for overseas remittances. The notification can be accessed **here.**

Banking Regulation Act, 1949 – Section 26A Depositor Education and Awareness (DEA) Fund Scheme, 2014 – interest rates payable on unclaimed interest-bearing deposit

In a circular dated 11 May 2021, the RBI has specified that the rate of interest would be 3% simple interest per annum payable by banks to depositors on the unclaimed interest bearing deposit amount transferred to the DEA Fund with effect from the date of this circular. The other contents of the circular remain unchanged.

Formation of new district in the State of Karnataka – assignment of lead bank responsibility

In a circular dated 27 May 2021, the Government of Karnataka has notified the formation of new district Vijayanagara (erstwhile district of Ballari). It has been decided to assign the lead bank responsibility to the State Bank of India. The district code allotted is ‘00S’ for Basic Statistical Return (BSR) reporting by banks.

03 Other regulatory news

Security Exchange Board of India (SEBI) issued a circular on Business Responsibility and Sustainability Reporting (BRSR) by listed entities

SEBI has issued a circular dated 10 May 2021 containing the BRSR format. This is a notable departure from the Business Responsibility Report (BRR) and a significant step towards bringing BRSR on par with financial reporting.

The reporting was finalised based on public consultation and extensive discussions with stakeholders like corporate and institutional investors. A benchmarking exercise with internationally accepted disclosure frameworks was also undertaken.

A few key disclosures sought in this report are ESG risks and opportunities, sustainability goals and performance, environment, and social-related disclosures, etc.

BRSR shall be applicable to the top 1,000 listed entities (by market capitalisation). The reporting shall be voluntary in FY 2021–22 and mandatory in FY 2022–23. The detailed notification can be accessed **here.**

SEBI seeks public comments on report submitted by the Technical Group on Social Stock Exchange (SSE)

SEBI has constituted a Working Group (WG) on SSE in September 2019 under the chairmanship of Ishaat Hussain. The WG has made appropriate recommendations and the report was put in the public domain for comments.

While analysing the comments it was felt that further expert advice was needed on certain critical operational issues before firming up views in this matter. Accordingly, a TG was formed by SEBI in September 2020 under the chairmanship of Dr. Harsh Kumar Bhanwala (ex-Chairman, NABARD).

The TG was tasked with developing a framework for on-boarding non-profit organisations (NPOs) and for-profit social enterprises (FPEs) on SSEs and recommending the scope of work, eligibility criteria and regulations for social auditors. The comprehensive notification can be accessed here.

Insurance Regulatory and Development Authority of India's (IRDA) letter on availability and renewal on COVID-specific products

IRDA received complaints stating that some insurance companies are not issuing Corona Kavach and Corona Rakshak Policies. On 6 May 2021, all insurers, as applicable, were advised to continue offering and renewing these policies. A copy of the letter can be accessed **here.**

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SEBI enhances overall limit for overseas investment by alternative investment funds (AIFs)/venture capital funds (VCFs)

In a **circular** dated 21 May 2021, SEBI, in consultation with the RBI enhanced the overall limit for overseas investment by AIFs/ VCFs to USD 1,500 million from USD 750 million.

The circular is issued in exercise of powers conferred under Section 11(1) of the Securities and Exchange Board of India Act, 1992, to protect the interests of investors in securities and to promote the development of and to regulate the securities market. All other requirements, terms and conditions remains unchanged.

04 Global regulatory news

Financial Conduct Authority (FCA) launched a consultation for a new category of fund designed to invest in long-term, illiquid assets

The proposed fund is to be open-ended and would be able to invest in venture capital, private equity, private debt, real estate, and infrastructure, usually referred to as productive finance. The successful existence of these funds can help businesses and infrastructure projects have access to long-term capital to support investment and wider economic growth.

FCA is hence proposing long-term asset funds (LTAFs) that would embed longer redemption periods, high level of disclosures and specific liquidity management and governance features. The detailed publication can be accessed **here.**

The European Securities and Markets Authority (ESMA) calls for evidence on digital finance

Through this call, the European Union's market regulator, ESMA, aims to gather relevant information on issues, including value chains, platforms and groups, provision of financial and non-financial services. The feedback will contribute to ESMA's technical advice to the EU.

Digital transformation and innovative technologies will lead to better financial services to businesses and investors, possibly at a lower cost. This change is not risk-free and brings attention to cyber security, data management, concentration risk and competition. This will also raise regulatory and supervisory challenges because of its global and cross-sectoral nature. ESMAs advice will assist the EU to address these challenges and propose relevant changes to the existing legislative framework by mid-2022. The detailed notification can be accessed **here.**

FCA has set out plans for a new Consumer Duty, which will lead to higher protection in retail financial markets

Although firms are already bound by FCA rules and principles, there is evidence of practices that are harmful to customers. This may provide insight into why one in four respondents to the FCA's 2020 Financial Live Survey said they lack confidence in the financial services industry and only 35% of respondents agreed that firms were honest and transparent in dealing with them.

The proposed consultation is open for comments till 31 July 2021. The FCA will propose rule changes by the end of 2021 and with new rules by end of July 2022. The detailed publication can be accessed **here.**

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Acknowledgements

This newsletter has been researched and authored by Praveen Ravichandran and Prachi Gujare.

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Data Classification: DC0 (Public)

PD/August 2021 - 14033