Macroprudential Policymaking An Indian Experience

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Macroprudential Regulation in India

- Macroprudential regulation to address both dimensions of systemic risk
  - Time Dimension
  - Cross-Sectional Dimension

- Largely based on discretion
  - Select quantitative and qualitative indicators guide policy action

- Applied primarily on banks as they are central to Indian financial system

Implementation of the countercyclical policies

- Implementation of countercyclical policies can be divided into three phases that correspond to distinct phases from monetary policy perspective.
- The monetary tightening and easing phase corresponds respectively to increase in sectoral capital and provisioning requirements (build up phase) and easing of these requirements (release phase).
- The period wise classification from this perspective is
  - Build-up phase: September 2004- August 2008,
  - Release Phase: October 2008- April 2009, and
  - Re-build-up phase: October 2009 till date.

Unique dimensions of the Reserve Bank's countercyclical policies

- Approach to the countercyclical policy has not been rule bound
- Empirical and anecdotal evidence were used to confirm policy judgements
- Coordinated approach to implementation of monetary and macroprudential policy
- Such coordination was rendered possible due to the multiple roles of the Reserve Bank

Co-ordinated Policy Response

Sr.No.	Measure	Monetary Tightening Phase (September 2004-August 2008)	Monetary Easing Phase (October 2008-April 2009)	Monetary Tightening Phase (October 2009 till date)
1	2	3	4	5
	Monetary Measures			
1	Repo rate	300	-425	250
2	Reverse repo rate	125	-275	300
3	Cash reserve ratio	450	-400	100
	Provisioning Norms			
4	Capital Market Exposures	175	-160	0
5	Housing Loans	75	-60	160*
6	Retail Loans other than Housing Loans	175	-160	0
7	Commercial Real Estate Loans	175	-160	60
8	Non-Deposit taking Systemically Important Non-Financial Companies	175	-160	0
	Risk Weights			
9	Capital Market Exposures	25	0	0
10	Housing Loans	-25 to 25@	0	0-25#
11	Retail Loans other than Housing Loans	25	0	0
12	Commercial Real Estate Loans	50	-50	0
13	Non-Deposit taking Systemically Important Non-Financial Companies	25	-25	0

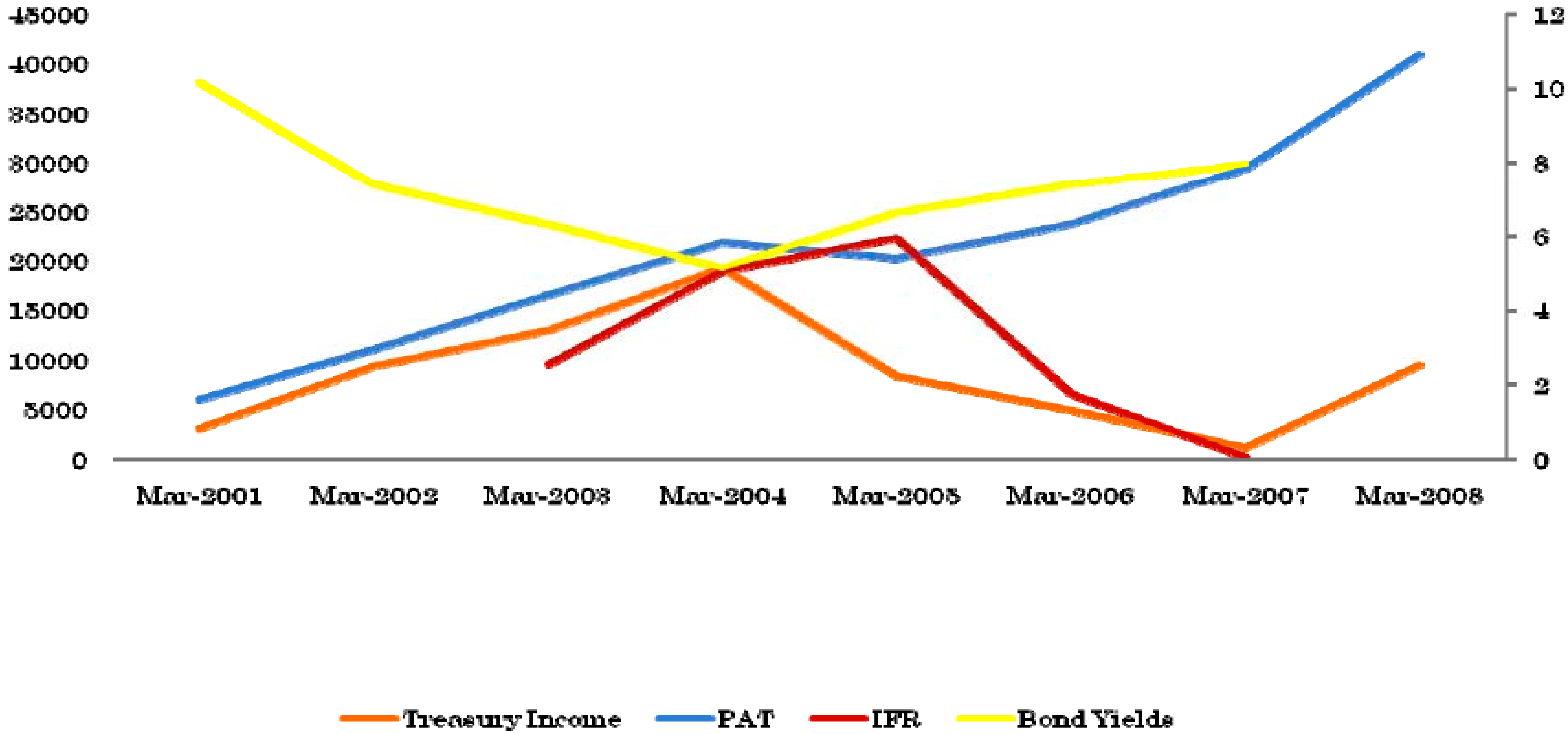
* Provisioning requirement for housing loans with teaser interest rates was increased to 2.0 per cent in Dec 2010

@ Risk weights on housing loans of relatively smaller size classified as priority sector was reduced from 75% to 50% in May 2007, which was not a countercyclical measure but rather an attempt to align the risk weights on secured mortgages with the provisions of Basel II which was to be implemented w.e.f. March 2008. On the larger loans and those with LTV Ratio exceeding 75% the risk weight was increased from 75 to 100%

The risk weight on loans above Rs. 7.5 million was increased to 125%.

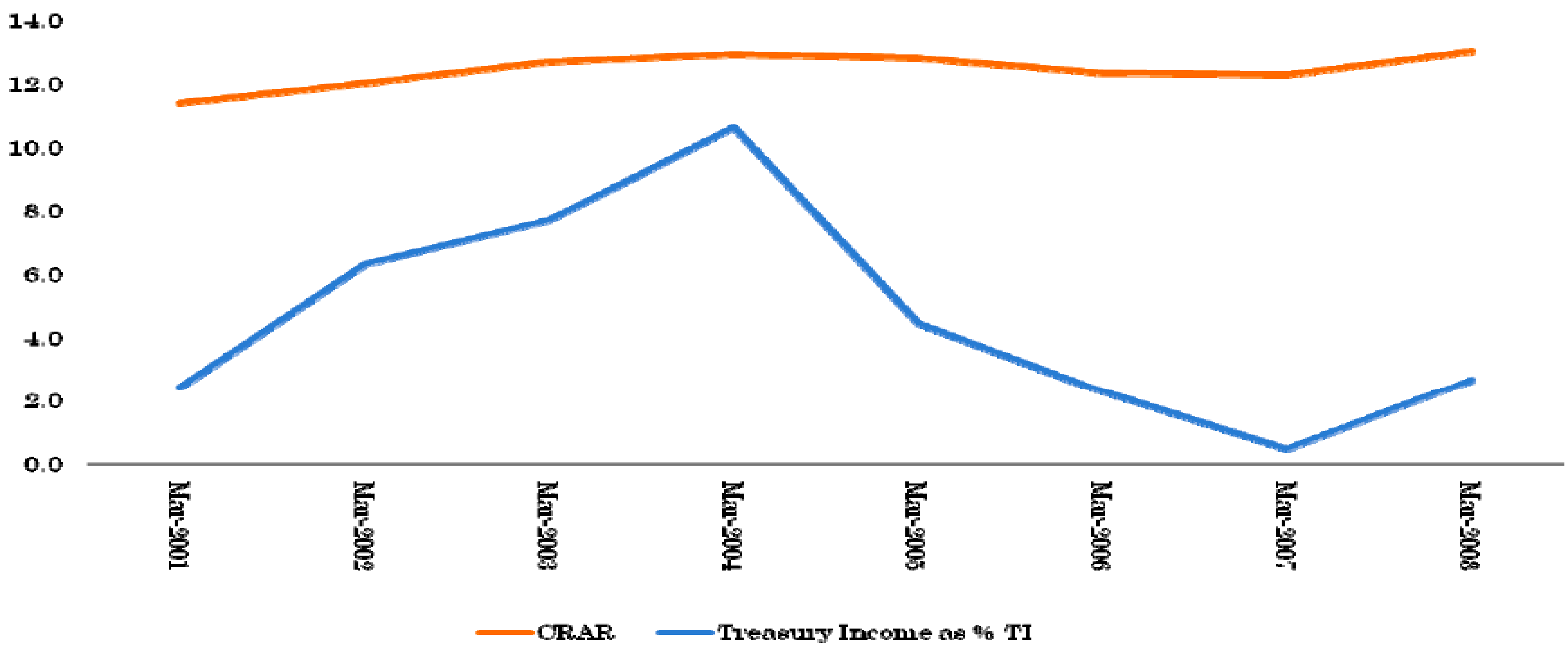
Source: Address by Mr. Anand Sinha, Deputy Governor, RBI on "*Seeing both the Forest and the Trees- Supervising Systemic Risk*" , *June 2011*

Time Dimension of Systemic Risk Investment Fluctuation Reserve (IFR)



IFR introduced as a counter-cyclical measure enabled banks to absorb losses when interest rates rose beginning late-2004. It was withdrawn once market risk capital charge was applied.

Time Dimension of Systemic Risk IFR (contd..)



CRAR remained stable despite introduction of capital charge for market risk and falling income due to rise in yields

Time Dimension of Systemic Risk

Time-Varying Risk Weights and Provisioning

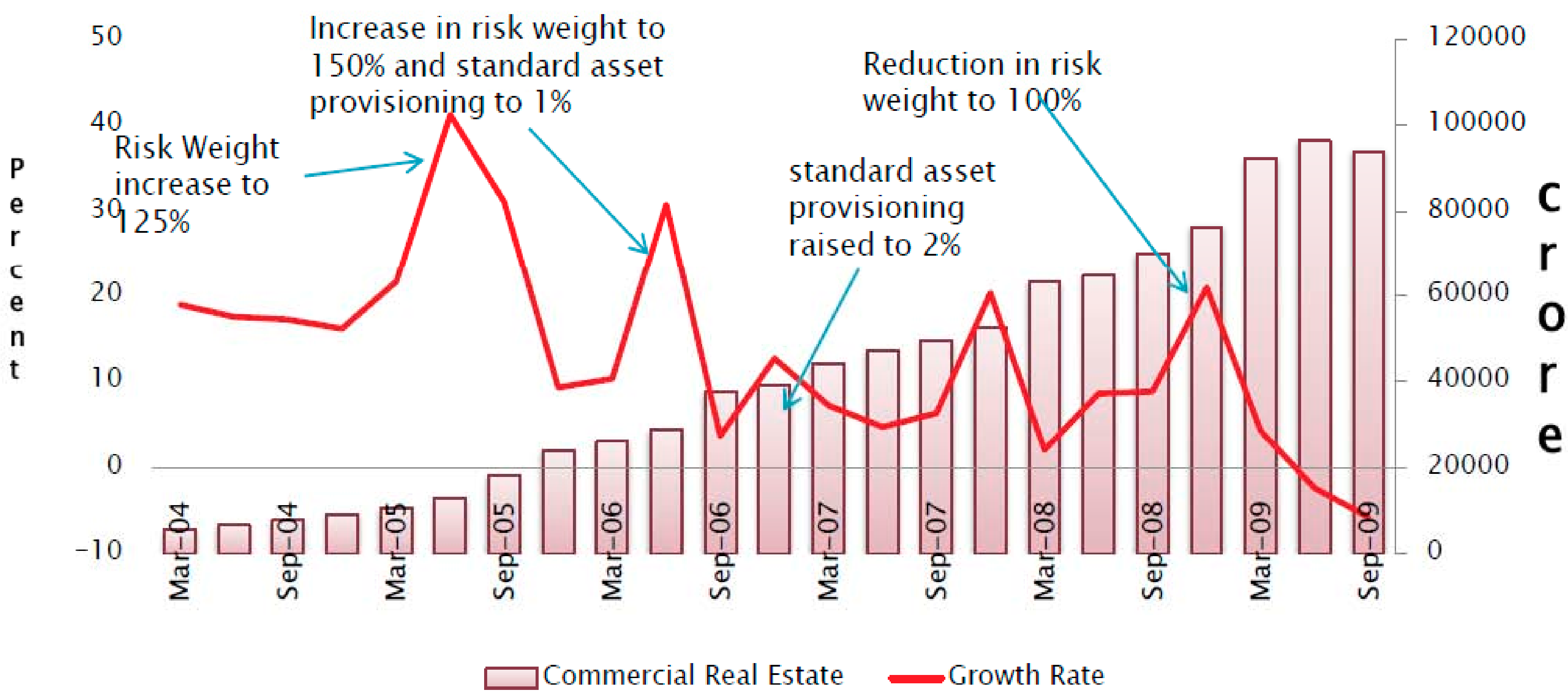
	Capital Market		Housing		Other Retail		Commercial Real Estate		Non-Deposit taking Systemically Important Non-Financial Companies	
Date	Risk Weight	Provisions (%)	Risk Weight	Provisions (%)	Risk Weight	Provisions (%)	Risk Weight	Provisions (%)	Risk Weight	Provisions (%)
Dec-04	100	0.25	75	0.25	125	0.25	100	0.25	100	0.25
July-05	125	0.25	75	0.25	125	0.25	125	0.25	100	0.25
Nov-05	125	0.40	75	0.40	125	0.40	125	0.40	100	0.40
May-06	125	1.00	75	1.00	125	1.00	150	1.00	100	0.40
Jan-07	125	2.00	75	1.00	125	2.00	150	2.00	125	2.00
May-07	125	2.00	50-75	1.00	125	2.00	150	2.00	125	2.00
May-08	125	2.00	50-100	1.00	125	2.00	150	2.00	125	2.00
Nov-08	125	0.40	50-100	0.40	125	0.40	100	0.40	100	0.40
Nov-09	125	0.40	50-100	0.40	125	0.40	100	1.00	100	0.40
Dec-10	125	0.40	50-125*	0.40-2.00#	125	0.40	100	1.00	100	0.40

Provisioning requirement for housing loans with teaser interest rates was increased to 2.0 per cent in December 2010. It will remain at 2% till one year after reset of interest rate to higher rate and thereafter it will be 0.4%. For other housing loans the provisioning will remain at 0.4%.

Source: Address by Mr. Anand Sinha, Deputy Governor, RBI on "*Seeing both the Forest and the Trees- Supervising Systemic Risk*" , *June 2011*

Time Dimension of Systemic Risk

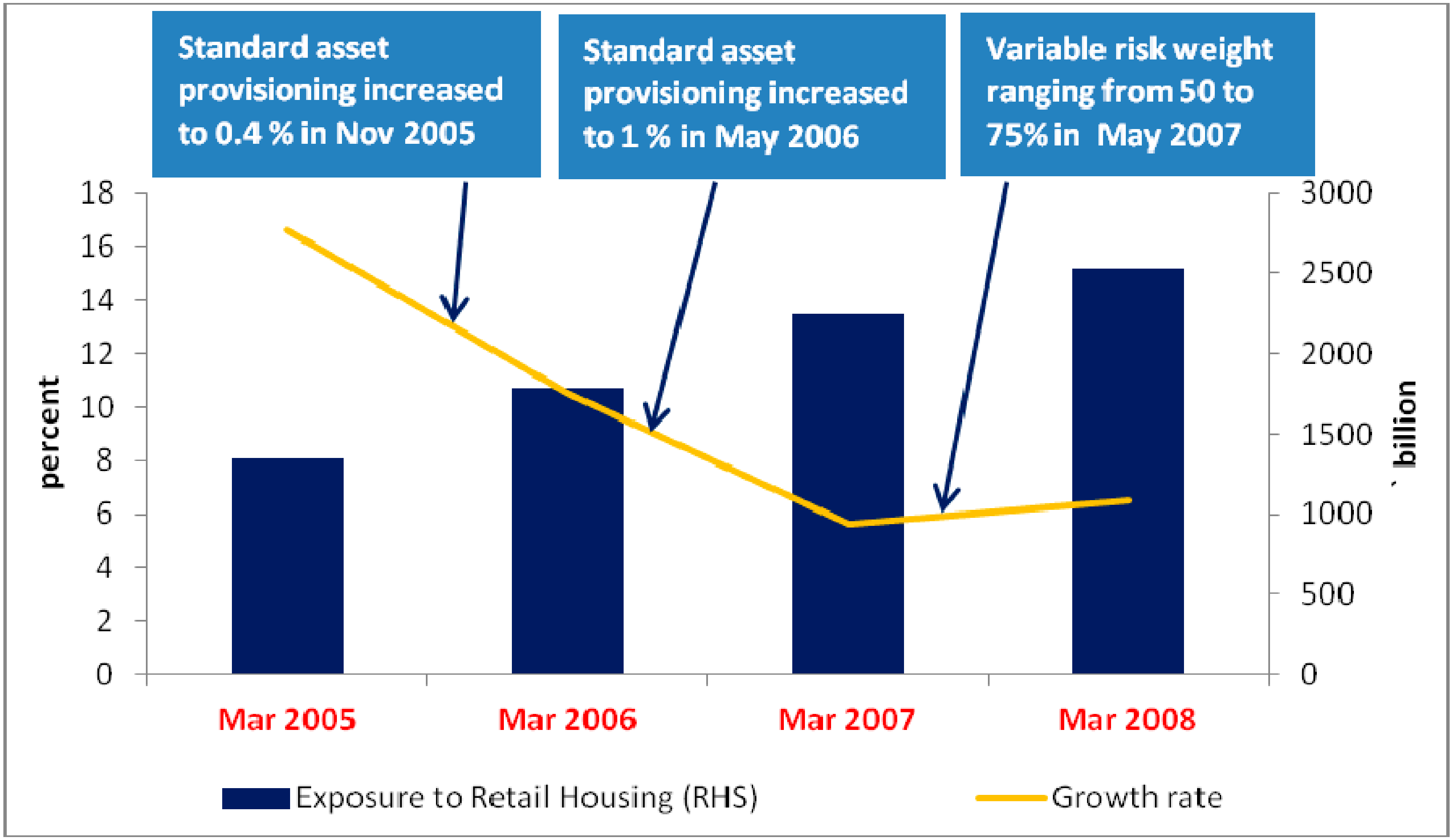
Time-varying Risk Weights and Provisioning (contd..) - Commercial Real Estate



Raising of risk weights has second order impact on bank advances to CRE in terms of reversing its growth rate.

Time Dimension of Systemic Risk

Time-varying Risk Weights and Provisioning (contd..) – Retail Housing - 1



Time Dimension of Systemic Risk

Time-varying Risk Weights and Provisioning (contd..) – Retail Housing - II

- Teaser loans : standard asset provisioning on the outstanding amount has been increased from 0.4 per cent to 2 per cent in November 2010

- Restriction of Loan to Value ratio of housing loans to 80 per cent (90 per cent for loans up to INR 2 million) and increase in the risk weights on large housing loans (INR 7.5 million and above) to 125 per cent in order to prevent excessive leveraging.

Time Dimension of Systemic Risk Countercyclical Provisioning Buffer

- Stipulation of Provisioning Coverage Ratio in December 2009, of 70% of gross NPAs as on a particular date
- Excess of provisions for PCR over that required under prudential norms segregated into a "countercyclical provisioning buffer"
- This buffer will be used by banks for making specific provisions for NPAs during periods of system wide downturn, with the prior approval of RBI

Time Dimension of Systemic Risk (contd..)

Capital flows

- **Managing capital outflows by encouraging inflows**
  - Inflows for ECBs maturing in 3-5 years, the cap on all-in-cost has been increased from Libor+300 basis points to Libor+350 basis points
  - NRE interest rates were deregulated

- **Managing excessive capital inflows**
  - MFs are permitted to invest abroad upto US$7 billion currently (increased from a mere US$ 500 million a few years ago).
  - Corporates can invest abroad for upto 400 per cent of their networth currently, increased over the period from 100 per cent of networth earlier.

Cross-sectional Dimension of Systemic Risk

Interconnectednes between banks

- Limits on interbank liabilities
  - IBL of a bank should not exceed 200 per cent of its net worth as on 31st March of the previous year.
- Restricted access to un-collateralised funding market
  - Access only to banks and primary dealers
  - Limits on borrowing and lending
- Limit on Cross holding of Capital among Banks / Financial Institutions
  - 10 per cent (of the investing bank's capital funds) limit on banks' investment in isntruments issued by other banks (Tier I plus Tier II).
  - 5 per cent (of equity capital) limit on acquiring fresh stake in a bank's equity share.

Cross-sectional Dimension of Systemic Risk

Interconnectednes (contd..)

- between banks and other entities in the financial sector
  - Cap of 10 per cent (of net worth) on banks' investment in mutual funds
  - Limits on exposure (both lending and investment, including off balance sheet exposures) of a bank to NBFC / NBFC-AFC (Asset Financing Companies) Infrastructure Finance Companies (IFCs)

Cross-sectional Dimension of Systemic Risk (contd..)

Common and Large Exposures

- **Single and Group Exposure Limits**
  - 15 per cent (of capital funds) in case of a single borrower and 40 per cent of capital funds in the case of a borrower group
- **Limits on exposure to sensitive sectors**
  - Exposures to the capital market are subject to a limit of 40 per cent (of net worth).
  - Banks' exposures to sensitive sectors such as the real estate, systemically important NBFCs and the commodity sector are closely monitored.
  - Banks are encouraged to place internal sectoral limits on other segments as well so as to ensure that their aggregate exposures are well dispersed.

Thank you…