The Evolving Facets of Regulations

Keynote Address by Shri Sanjay Malhotra, Governor,

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I am delighted to be here amongst all of you in the SBI Banking and Economics Conclave. I sincerely thank Chairperson, SBI for providing me this opportunity to address the leaders of the banking and finance in the country. This Conclave is happening at a time when we are navigating a world of continued uncertainty, geopolitical realignment, and rapid technological change. This brings not only a host of challenges but also many opportunities.

2. I recall that about a year ago, when I addressed this Conclave in my capacity as Revenue Secretary, I spoke about tax reforms. In my address today, I propose to dwell on the recent regulatory measures the RBI has taken. Earlier, we had issued the Regulation making Framework. We follow a consultative process, do an impact analysis and provide the objectives of the regulations. In the spirit of this framework, I wish to shed some more light on the objectives and the rationale of the major regulations.

The Purpose of "Regulation"

3. In this context, I would also like to reiterate what I said in my first MPC statement in February this year. The interest of the national economy demands financial stability. For us in the Reserve Bank, financial stability remains the north star, for short term growth achieved at the cost of financial stability can have bigger consequences for long-term growth. Research shows that financial instability may not only more than offset the gains of higher short term growth, but also make recovery more distressful and longer.

4. At the same time, economic interest warrants increasing efficiency, and promoting innovation, which too is our duty. We recognise that just like there are no free lunches, regulation to enhance stability too is not devoid of costs. There are trade-offs between stability and efficiency.

5. I had assured that we will keep this trade-off in mind while formulating regulations. I had mentioned that it will be our attempt to strike the right balance, keeping in view the benefits and costs of each and every regulation. The recent

regulatory proposals strive to maintain this balance - the balance between the drive to innovate and grow and the duty to protect.

6. Moreover, in a rapidly evolving banking system, underpinned by technological advancements of tectonic magnitude, no regulator can afford to situate the system at a point in time. The role of the regulator is to guide its evolution within guardrails that ensure stability, fairness, and resilience.

7. In India, this philosophy has found steady expression in RBI's approach towards regulation, what might be called ***responsive conservatism*** - a model that prizes stability yet remains open to reform.

The Backdrop

8. In this context, it would be germane to briefly recap the developments over the past decade in the Indian financial system.

9. Post GFC, in the wake of aggressive fiscal and monetary stimulus, the ensuing regulatory forbearance sowed the seeds of the *"twin balance sheet"* problem - overleveraged corporates and stressed bank balance sheets. Coupled with the manifestation of external sector vulnerabilities, India got clubbed among the so-called "Fragile Five."

10. Guided by the principle "*never waste a good crisis*", the period from 2014 led to a foundational surgery to restore the long-term health of the financial system.

11. This was driven by a series of regulatory measures aimed at recognition, resolution and recapitalisation of the banking system. The Asset Quality Review (AQR), initiated in 2015, compelled banks to recognise the true state of their loan books, bringing hidden NPAs onto balance sheets. Significant improvements were also brought about in the supervisory framework.

12. Simultaneously, Prompt Corrective Action (PCA) framework helped restore the health of weak banks. It was followed by consolidation of 27 public sector banks into 12 by 2020. These measures were complemented by a massive recapitalisation programme, which strengthened capital buffers and restored their capacity to resume healthy lending.

13. The introduction of IBC in 2016, and the pursuant resolution paradigm introduced through out of court workout mechanisms, have fundamentally transformed India's credit culture.

14. Parallelly, major reforms were undertaken to strengthen monetary and macroeconomic stability, including the adoption of a flexible inflation-targeting regime, deepening of forex markets, and the gradual liberalisation on the capital account.

15. The recent past has also seen structural transformation of financial intermediation into a sophisticated and layered system. Nimble FinTechs and NBFCs now assume a greater role in sourcing and origination. Development of capital markets and credit risk transfer channels such as securitisation now provide a conduit for risk transfers. The Project Finance Directions issued recently, address risks arising from regulatory approvals and availability of land. The proposed forward-looking ECL provisioning will help early recognition of deterioration in asset quality.

16. Moreover, Indian banks today are far more mature than they were a decade ago. To put this in perspective, credit and deposits have expanded to almost 3 times[1]. Capital buffers have strengthened too - the CRAR rose from 13.5 per cent as on 31st March, 2015 to 17.5 per cent as on 31st March, 2025 with CET-1 increasing from 10.43 per cent to 14.73 per cent during the same period. Asset quality has also improved. GNPA and NNPA have reduced to 2.3 per cent and 0.5 per cent in March 2025 after rising to highs of 11.2 per cent and 5.96 per cent respectively in March 2018. Profitability of banks has enhanced significantly. Between FYs 2017-18 and 2024-25, Return on Assets increased from -0.24 per cent to 1.37 per cent, and Return on Equity jumped from -2 per cent to 14 per cent. Regulation cannot ignore this performance, these changed realities.

17. This evolution implies that prudential rulebooks too should evolve in a calibrated manner as banks are now stronger and supervision more alert even as alternative risk-bearing pillars have deepened and market-based risk transfer mechanisms have become more effective.

18. The recent regulatory measures need to be seen in the backdrop of these developments. Let me now elaborate on a few measures.

Capital Market Exposure (CME)

19. I will first talk about the draft guidelines on capital market exposure. The proposals to enhance the limits for lending to individuals against securities and rationalise the norms for lending to capital market intermediaries are part of the normal process of review, seeking to reset the limits, set way back in 1999. Importantly, the

[1] ***Source***: *Compiled from RBI DBIE Returns*
Bank deposits: *2015 – 85.33 Lakh crore; 2025 – 225.8 Lakh crore*
Bank credit: *2015 – 65.36 Lakh crore; 2025 – 182.43 Lakh crore*

revision in limits has been accompanied by a more structured Loan to Value (LTV) framework, sensitive to the risks of the underlying securities.

20. The proposed removal of limits on loans against debt instruments, while retaining the regulatory limits for equity instruments, recognises the fundamental difference between the two instruments from a risk perspective. The key risk a debt instrument carries is credit risk, and just like loans, credit risk is expected to be managed as part of the broader credit risk management framework. An additional comforting factor is that only listed and investment grade debt securities are proposed to be permitted as collateral. This rationalisation is also expected to foster a virtuous positive feedback loop for the development of the bond market.

21. As regards acquisition finance, it is acknowledged as an integral element of an evolved financial system, that helps in better allocation of financial resources. Recognising its need, non-bank players such as NBFCs and bond markets are already allowed to provide such funding. Removal of the restriction on banks will benefit the real economy. The proposed guardrails like limiting bank funding to 70 per cent of deal value, limits on debt to equity ratio, aggregate exposure limits relative to Tier-1 capital, and eligibility criteria will contain concentration and credit risks, thereby ensuring safety while allowing banks and their stakeholders to reap benefits of additional business.

Market Mechanism for Large Borrowers

22. Let me now turn to the withdrawal of the Specified Borrower Framework.

23. This framework was instituted almost a decade ago, in a very different financial environment. This is a unique measure, which perhaps no other country that has implemented the Large Exposure framework (LEF), at the bank level, has. At that time, the banking system was grappling with elevated levels of stress, which is no longer the case. The tier 1 capital of the scheduled commercial banks has increased 3.2 times from about 8 lakh crore rupees in 2016 to more than 26 lakh crore rupees in the last ten years. On the other hand, overall share of exposure of the banks to corporates has considerably reduced since then. The regulatory landscape, as mentioned earlier, too has evolved significantly. The large exposure framework, which is aligned with international best practices, is now well-established and the supervisory tool kit is vastly improved. Therefore, it is proposed to substitute the blanket risk weights and provisions in the extant framework with better monitoring and risk management by the banks.

Reduction in Risk Weights for Infrastructure exposures of NBFCs

24. Coming to risk weights for infrastructure exposures of NBFCs, I would like to highlight that the proposal seeks to prescribe risk weights on the basis of the risk profile of the exposures. However, certain conditions have to be satisfied to qualify for a lower risk weight: one, there is a set of qualitative criteria that has to be fulfilled ab initio, including a suitable covenant to protect the interest of creditors through the tenor of the exposure; and two, a principal repayment criteria that would demonstrate a reasonable performance track record before risk weights can be lowered.

Revision in ECB norms

25. As regards, the External Commercial Borrowing (ECB) framework, these measures come against the backdrop of a strong external sector. India's current account recorded a surplus of USD 13.5 billion (1.3 per cent of GDP) in Q4 FY25, followed by a modest deficit of USD 2.4 billion (0.2 per cent of GDP) in Q1 FY26. Foreign exchange reserves stand at about USD 690–700 billion, sufficient to cover nearly 11 months of merchandise imports. Capital account remains robust. Net inflows to India under foreign investment (FDI and FPI), external commercial borrowings and NRI deposits stood higher at USD 30.4 bn during April-July 2025 than USD 26.8 bn in the same period last year. Our projections show that capital flows will remain quite strong during the rest of the year as well.

26. The recalibration of the ECB framework is a natural step in India's financial evolution - grounded in strong fundamentals, guided by prudence, and inspired by confidence in the economy's capacity to engage with global finance on its own terms.

27. The removal of all-in-cost ceilings will encourage competitive rates and promote prudent hedging behaviour. Expansion of the universe of eligible lenders will improve pricing efficiency.

28. Linking the borrowing limits to the borrower's net worth under automatic route links ECB to the strength of the borrower, while enhancing ease of doing business. This limit and the overall soft ceiling of total outstanding ECBs at 6.5 per cent of GDP will mitigate the risks of excessive external leverage.

29. Moreover, I wish to clarify that ECBs are proposed to be permitted only for FDI-compliant real estate projects and remain prohibited for speculative real estate activity such as land or property trading.

Epilogue

Appropriate and incremental regulations

30. To summarise, all these measures are balanced and appropriate, built on the bedrock of a banking system that has been systematically fortified over the last decade, with financial stability remaining the unwavering cornerstone of our policy architecture. All the changes are incremental in nature. As Shakespeare would say, *we are moving wisely and slow; they stumble that run fast*[2]. At the same time when we aspire to become a developed nation, while we move with caution, we need to display courage. Again, I am reminded of Shakespeare's line[3]: *Tis dangerous to take a cold, to sleep, to drink; but … out of this nettle, danger, we pluck this flower, safety.* So, these measures do reflect fresh thinking, but are incremental and do not introduce any sea change.

Regulation as a whole

31. Moreover, no regulatory measure can be understood in isolation. Each measure has to be seen in the continuum of regulatory evolution and not in isolation. These proposals must be read against the broader regulatory scaffolding, which mitigates the risks. Together, the regulations create a multi-layered defence, to keep systemic risk in check. Analysing merely one regulation without understanding the complete regulatory landscape risks missing the forest for the trees.

Amendments based on experience

32. Let me also highlight that the higher responsibilities placed on the banks are based on their past performance. This is on account of the improved governance and prudent decision-making by the banks over the last decade. As highlighted earlier, capital buffers are stronger, profitability better, and asset quality much improved. Regulation has to evolve keeping in mind the realities of time and the performance of the banks.

Promote learning and discovery

33. Moreover, no regulator can, or should, substitute for boardroom judgment, especially in a diverse country such as ours. Each case, each loan, each deposit, each transaction is different, with varying risks and opportunities. We need to allow the regulated entities to take decisions based on merits of each case, rather than

[2] *Romeo & Juliet, Shakespeare*

[3] Henry IV, Part 1.

prescribing a one size fits all rule. This will enable regulated entities to experiment and innovate, learn and improve.

Regulations with guardrails

34. At the same time, wherever we are allowing hitherto prohibited activities, or reducing restrictions, we have provided sufficient guardrails to ensure safety and prudence.

Regulation and supervision go hand in hand

35. I may also mention that the role of a regulator is like that of a gardener whose job does not stop with providing the “enabling environment” for the growth of the plants. The gardener keeps on monitoring the growth *of the plant and prune unwanted growth to shape a collective orderly beautiful garden*. RBI has ample tools - risk weights, provisioning norms, countercyclical buffers - to contain emerging risks. History shows our readiness to act, as seen most recently in the macroprudential measures of increasing risk weights on consumer credit in November 2023. Needless to say, supervisory actions have always enabled effective backstops to *prune unwanted growth and shape a robust and resilient banking system.*

36. Finally, let me emphasise that most of these are measures are in the form of drafts issued for formal consultation. These have been issued after great deliberation, informal consultation and thought, accompanied with detailed impact assessment, and while they do reflect the broad direction, they are not final. We will finalise them after taking inputs from all stakeholders.

Consumer grievance redress

37. Before I conclude, let me also touch upon the changes introduced with respect to consumer grievances. The Reserve Bank has maintained a persistent focus on enhancing customer service standards and strengthening grievance redressal systems.

38. In this direction, the Internal Ombudsmen framework in larger REs is proposed to be improved. The Reserve Bank Ombudsman Scheme is also being further fine-tuned to enhance its efficacy.

39. To sustain the regulator’s efforts, it is imperative that regulated entities address customer grievances through mechanisms that are fair, transparent, timely, and without undue cost. The regulated entities may please assess the quality of customer

service through periodic and regular thematic studies. In addition, effective Root Cause analysis of the grievances may also be conducted to identify systemic issues, process gaps and repetitive grievances and remedial measures taken.

40. I would request the MD&CEOs and other top executives present here for their full support and their personal attention in ensuring that the proposed changes, when they are made final, are implemented not only in letter but also in spirit.

Conclusion

41. To conclude, I would like to emphasise that our approach is calibrated: granting banks greater commercial leeway for growth, innovation and ease of doing business, while ensuring that risks are minimised and financial stability is maintained.

42. We have set ourselves an ambitious goal of becoming an advanced economy by 2047. The financial sector has a large role to play in it. RBI remains steadfastly committed to this goal. We will ensure that our financial system evolves responsibly to support innovation, growth, and long-term economic resilience.

43. I am sure that the deliberations in this Conclave will help in taking forward this developmental agenda. I commend SBI for this initiative and wish the Conclave a huge success.

44. Thank You. Jai Hind.