

MONETARY MANAGEMENT AND FINANCIAL INTERMEDIATION: REFINING THE REGULATORY TOUCH

India's monetary and financial sectors have exhibited robust performance in FY26 (April-December 2025), underpinned by strategic policy actions and structural resilience across financial intermediation channels. In response to moderating inflation, the Reserve Bank of India's Monetary Policy Committee reduced the repo rate, while injecting durable liquidity through cash reserve ratio cuts and open market operations. These measures have been effectively transmitted to lending rates, with the weighted average lending rates of scheduled commercial banks declining. The banking sector has simultaneously strengthened its fundamentals, with gross non-performing asset ratios declining to multidecadal lows and profit after tax increasing, signalling improved asset quality and profitability.

Capital formation has been particularly robust in primary equity markets. Household financial savings have increasingly shifted towards equities and mutual funds, with the share of equity-linked instruments in annual household savings rising, reflecting the deepening financialisation of domestic savings.

Financial inclusion has advanced substantially through digital public infrastructure, fintech lending, and government-led microcredit initiatives. India's first international financial service centre at GIFT City is creating an enabling ecosystem for attracting and channelling global capital. Significant strides have been made in providing social security cover to citizens in terms of pension and insurance.

While India's financial system is becoming more resilient, diversified, and inclusive, it faces new challenges emanating from dynamic forces. These challenges include the need to improve regulations, manage the use of AI in finance, and scale up to meet the demands of a growing, aspirational population. This necessitates that the regulatory authorities navigate prudently to reconcile growth with stability.

INTRODUCTION

3.1 Monetary management and financial intermediation are fundamental pillars of the economic structure, driving growth, stability, and financial inclusion. Monetary management, led by the Reserve Bank of India (RBI), involves regulating the money

supply, interest rates, and liquidity to ensure price stability while supporting sustainable economic growth. It also directly influences financial stability. Effective policy transmission through the banking and financial sector ensures that changes in interest rates and liquidity conditions are efficiently transmitted to businesses and households. This stability is crucial for sustaining growth and preventing financial crises, as a stable financial system enables the smooth allocation of resources and fosters economic resilience in the face of global and domestic shocks.

3.2 The vastly interconnected global financial architecture of today was built and developed in the era of rapid globalisation. Globalised finance has led to lower borrowing costs, greater access to capital, and improved international risk sharing.¹ However, in the presence of rapid geopolitical fragmentation, the financial sector has become a channel for the transmission of global shocks. Thus, emerging markets face the task of leveraging the benefits of globalised finance and simultaneously minimising the costs that stem from volatile shocks. In this context, regulatory innovation, transparency, and accountability are crucial for addressing the challenges of an uncertain era. Moreover, tapping into innovative and inclusive channels of domestic finance is necessary, as these can serve as a buffer against shocks to volatile global finance and simultaneously advance the goals of growth and development.

3.3 This chapter outlines the trends in India's financial sector against the backdrop of these global developments. The chapter begins with an exploration of trends in the global financial sector. Subsequently, the next section provides a comprehensive overview of key developments in the monetary sector in India. This is then followed by sections which cover various aspects of the financial sector, including banking, capital and debt markets, foreign portfolio investments, pensions, and insurance. In view of the agile responses demonstrated by regulators across the financial sector, the chapter places specific emphasis on regulatory achievements and on the role of financial sector regulators in maintaining stability while identifying areas requiring improvement. The chapter concludes with a financial sector outlook, highlighting the key challenges that lie ahead.

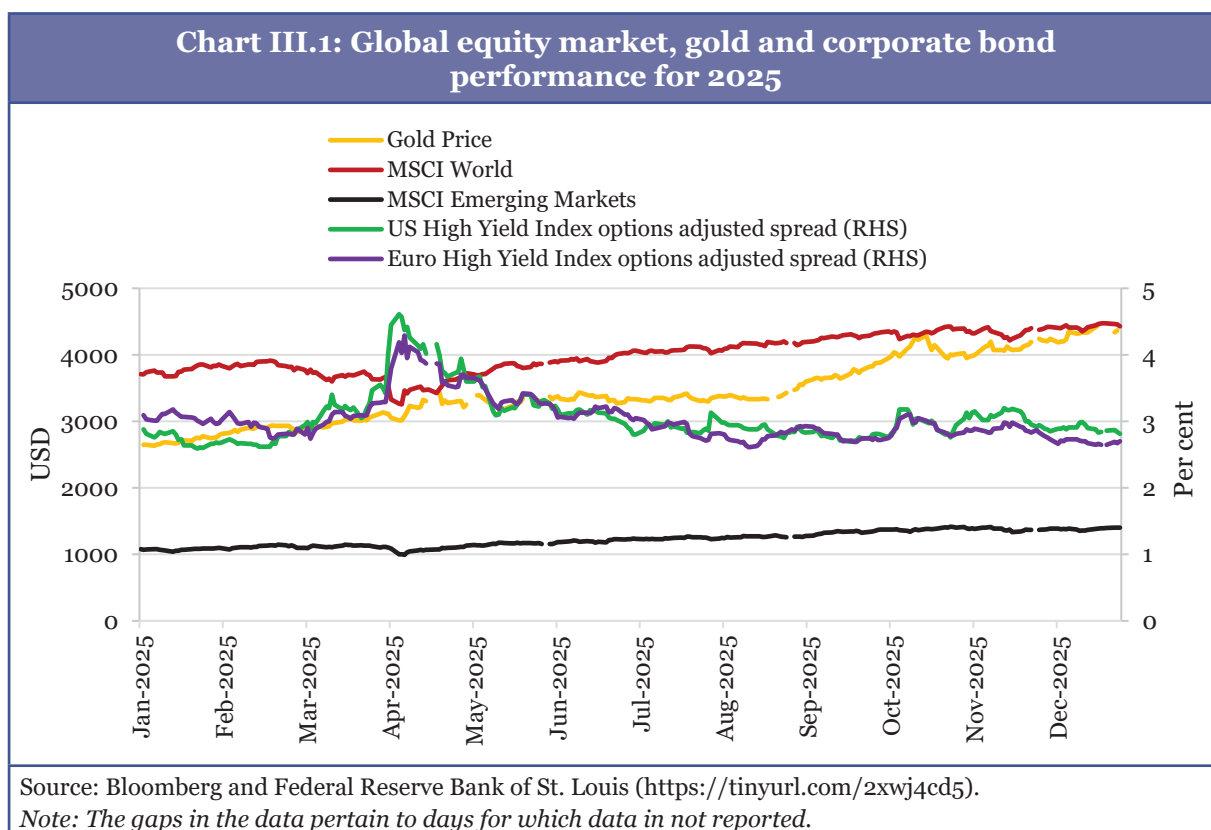
GLOBAL FINANCIAL MARKETS – UNCERTAINTY AND OTHER EMERGING RISKS

3.4 Financial markets are typically the first to register and absorb the impact of an uncertainty shock. Much before agents across government, trade, and households adjust their choices, financial market participants tend to respond by pricing in uncertainty

¹ Kose, M. A., Prasad, E., Rogoff, K., & Wei, S.-J. (2006). Financial globalization: A reappraisal (IMF Working Paper No. WP/06/189). International Monetary Fund, <https://tinyurl.com/mwu2t34a>.

risk in real time. The year 2025 was marked by heightened uncertainty, which had a palpable impact on financial markets.

3.5 The first half of calendar year (CY) 2025 saw the global financial markets reacting to the tariff announcements by the US government. Global policy uncertainty increased following the announcement, prompting investors to reduce their exposure to the US Dollar (USD) and seek safe-haven assets, such as gold. Global equity markets dipped, and risk premiums rose across asset classes in April 2025. (Chart III.I). Subsequently, financial market volatility subsided and returned to normal once some of the US government's announcements were reversed.



3.6 The impact of uncertainty on financial markets is not just limited to a rise in volatility and risk premia. Research shows that prolonged periods of uncertainty can affect the financial sector through at least three key channels. First, financial market participants are seen to defer decisions in the presence of uncertainty (via the real options channel). A rise in uncertainty will trigger a ‘wait-and-see’ sentiment, delaying investments and capital formation (Dixit & Pindyck, 1994).² Second, heightened uncertainty can raise the cost of finance through a rise in credit spreads (Manzo, 2013)

² Dixit, A. K., and R. S. Pindyck. (1994) Investment under Uncertainty. Princeton University Press.

and financial intermediation costs (Francis, Hasan & Zhu, 2014).^{3,4} In turn, this can impact the real economy by impeding the flow of credit. Finally, prolonged uncertainty can increase the possibility of sharper market corrections across asset classes.⁵ In some cases, these market corrections can pave the way for financial contagion, spreading to the entire financial sector and the real economy.

3.7 In addition to the above risks, global financial markets grapple with the impact introduced by new technologies such as artificial intelligence (AI). The IMF's Financial Stability Report (FSR) of October 2025 notes that there is a higher likelihood of herding behaviour in financial markets, as global investors use similar AI models. The report also notes that, compared to previous decades, investors have become increasingly sensitive to micro-information signals transmitted through social media. These trends suggest the possibility of longer and more amplified shocks in global financial markets. Parallely, technology stocks pose an emerging risk of inflated valuations, with AI-related stocks accounting for 75 per cent of S&P 500 returns, 80 per cent of earnings growth, and 90 per cent of capital spending growth since ChatGPT launched in November 2022.⁶ At the same time, as noted by the IMF, structural vulnerabilities such as rising global government debt and aggressive risk-taking among non-bank financial institutions remain capable of intensifying the effects of emerging shocks.⁷ At the same time, digital assets such as the Stablecoin are gaining traction and playing a larger role in financial intermediation. As of 31 December 2025, the total market capitalisation of stablecoins stands at USD 305.4 billion, marking a 49.6 per cent increase this year.⁸ Stablecoins' rising market capitalisation and increasing interconnections with the traditional financial system have reached a stage where potential spillovers to that system can no longer be ruled out.

3.8 Amidst such uncertainties, it is relevant to understand whether and how firms' investment decisions are affected. Box III.1 empirically estimates the impact of prolonged periods of uncertainty on capital formation by firms in India.

3 Manzo, G. (2013). Political uncertainty, credit risk premium and default risk. *Credit Risk Premium and Default Risk* (August 31, 2013), <http://dx.doi.org/10.2139/ssrn.2376608>.

4 Francis, B. B., Hasan, I., & Zhu, Y. (2014). Political uncertainty and bank loan contracting. *Journal of Empirical Finance*, 29, 281-286, <https://doi.org/10.1016/j.jempfin.2014.08.004>.

5 Catalán, M., Deghi, A., & Qureshi, M. S. (2024, October 15). How high economic uncertainty may threaten global financial stability: Unknowns raise risk of financial market volatility and a sharp decline in economic growth. *International Monetary Fund*, <https://tinyurl.com/5uprvmaa>.

6 Lichtenberg, N. (2025, October 7). 75% of gains, 80% of profits, 90% of capex—AI's grip on the S&P is total, and Morgan Stanley's top analyst is 'very concerned'. *Fortune*, <https://tinyurl.com/y3jjasfe>.

7 International Monetary Fund. (2025, October 14). *Global Financial Stability Report, October 2025: Shifting ground beneath the calm*, <https://tinyurl.com/3fej6p64>.

8 DefiLlama. *Stablecoins (Data dashboard)* <https://tinyurl.com/3yys62da>, accessed on 24 January 2025.

Box III.1: Capital formation amidst uncertainty shocks - a study of listed firms in India

Uncertainty shocks have become a defining feature of the present era. While these shocks are essentially geopolitical in nature, they also stem from technological shifts and policy changes. This box seeks to understand how capital formation choices of firms in India respond to such shocks.

Literature establishes that firms delay investment in the presence of uncertainty due to factors such as increased costs of financing (Christiano et al., 2014)⁹ and a rise in the ‘option value’ of delaying investment (Dixit & Pindyck, 1994).¹⁰ However, in some scenarios, firms may choose to invest despite an uncertain environment. For example, firms in strategic sectors may invest in R&D despite economic uncertainty, anticipating higher future payoffs (Weeds, 1999).¹¹ Similarly, factors such as asset size, market power, market concentration, and growth opportunities impact a firm’s choice to invest irrespective of uncertainty.¹² Given this heterogeneity, a detailed exploration is warranted to understand how firm investment behaviour in India responds to uncertainty shocks.

There is a wide variety of literature that attempts to model uncertainty, which is, in fact, a latent variable that cannot be directly observed. One category of research uses media coverage to track the frequency of specific keywords related to uncertainty (See, for example, the widely used Economic Policy Uncertainty (EPU) index by Baker and Bloom).¹³ A second category frames uncertainty based on qualitative data from forecasters. A third category quantifies uncertainty as a residual, unobserved variable that varies over time.¹⁴

Data and model

The present study covers 811 listed firms in India for the period from 2010 to 2024.¹⁵ The sample comprises a heterogeneous mix of large (63 per cent), mid-sized (28.7 per cent), and small firms (8.3 per cent), operating across diverse sectors ranging from infrastructure and mining to retail and wholesale distribution. Nearly 25 per cent of the firms exhibit a strong

9 Christiano, L. J., Motto, R., & Rostagno, M. (2014). Risk shocks. *American Economic Review*, 104(1), 27-65, <https://tinyurl.com/ycxfedh2>.

10 Ibid note 2.

11 Weeds, H. (1999). “Sleeping Patents and Compulsory Licensing: An Options Analysis.” University of Warwick Economic Research Papers (No. 540).

12 See, for instance, Mohades Forooshani, S. S., Piccillo, G., & Treibich, T. (2024). Unpacking Economic Uncertainty: Measuring the Firm, Sector and Aggregate Components. CESIFO WORKING PAPERS, 10974, <https://tinyurl.com/z9kjfpwd>; Bar-Ilan, A., & Strange, W. C. (1996). Investment lags. *The American Economic Review*, 86(3), 610-622, <https://tinyurl.com/4tj4j8nn>; and Castelnuovo, E., Tuzcuoglu, K., & Uzeda, L. (2022). Sectoral uncertainty, <http://dx.doi.org/10.2139/ssrn.4259631>.

13 Baker, S. R., Bloom, N., & Davis, S. J. (2016). Measuring economic policy uncertainty. *The quarterly journal of economics*, 131(4), 1593-1636, <https://doi.org/10.1093/qje/qjw024>.

14 For a detailed review of the various methods of uncertainty measurement, please refer to Cascaldi-Garcia, D., Sarisoy, C., Londono, J. M., Sun, B., Datta, D. D., Ferreira, T., ... & Rogers, J. (2023). What is certain about uncertainty? *Journal of Economic Literature*, 61(2), 624-654, <https://tinyurl.com/57mryhfn>.

15 Data is sourced from the CMIE Prowess database.

export orientation.¹⁶ The study period encompasses several significant shocks, including the taper tantrum (2013), the twin balance sheet crisis (2016–2018), the COVID-19 pandemic (2020–2021), and heightened global geopolitical tensions (2022–2023).

Uncertainty is modelled as a common unobserved shock affecting all firms at time t . The study employs a panel SVAR framework (Pedroni, 2013), which offers several advantages for the data under consideration.¹⁷ First, it accommodates unbalanced firm-level panel data. Second, it accounts for potential endogeneity among variables. Third, it captures rich information from a wide cross-section ($N = 811$) despite the relatively short time dimension ($T = 15$).

The impact of uncertainty shocks on capital formation is estimated using the following firm-level equation, where $i = 1$ to 811:

$$K_{it} = f(\Pi_{it}, \text{Liquidity}_{it}, \text{Borrowings}_{it})$$

Where K_{it} refers to capital formation, which is captured by the change in net fixed assets of the firm i at time t ; $\Pi_{(it)}$ refers to the profits after taxes, Liquidity_{it} is taken as the ratio of cash and bank balances as a share of total assets, and Borrowings_{it} is captured by reported firm borrowings. These variables are selected based on firm-level literature on capital formation dynamics (Dhasmana, 2025).¹⁸

The model treats uncertainty as an unexpected, common shock to profits across all firms in the sample. Firms respond to this shock heterogeneously, as reflected in their individual impulse response functions for capital formation. The 811 individual impulse responses are then studied to construct an overall picture of firm-level capital formation following an uncertainty shock.

Findings of the study

The main variable of interest - capital formation- is standardised by taking it as a share of a firm's total net fixed assets (NFA). This allows for easier interpretation at an aggregate level. The standardised variable is thus defined as the change in NFA as a share of total NFA (K_i / NFA_i) where K_i is capital formation following an uncertainty shock and NFA_i is a firm's latest NFA position (as of 2024).

The study reveals that an uncertainty shock, on average, induced firms to undertake negative

16 The study classifies a firm as an 'exporter' if its export share of revenue averaged at least 20% across the 15 years studied.

17 Pedroni, P. (2013). Structural Panel VARS. *Econometrics*, 1(2), 180-206. <https://tinyurl.com/yn6edazb>. Pedroni's Panel Structural Vector Autoregressive (SVAR) framework captures the heterogeneity of large N , small T samples without introducing any bias into the estimations. Furthermore, it is suited for unbalanced panels and helps model uncertainty as a common latent shock variable across firms. Specifically, using Pedroni 2013's SVAR framework, uncertainty is modelled as follows:

$$\epsilon_{it} = \eta_i \bar{\epsilon}_i + \mu_{it}$$

where ϵ_{it} is the white noise shock for an endogenous variable of firm i at time t , which is expressed as the sum of a common shock $\bar{\epsilon}_i$ and an idiosyncratic firm-specific shock μ_{it} .

18 Dhasmana, A. (2025). Economic policy uncertainty and underinvestment in Indian firms, <https://tinyurl.com/48ksa7np>.

capital formation, i.e., reduce 0.51 per cent of their net fixed assets over five years - although the impact varies significantly across firm characteristics. Categorisation of the firms by size, export orientation and sector reveals the following: -

- (i) **By size**¹⁹: Large firms (top decile) reduced 0.5 per cent of their NFA on average, while mid-sized firms showed the steepest decline at 4.7 per cent. As opposed to mid-sized firms, small firms proved to be more resilient, reducing their net fixed assets by only 1 per cent.
- (ii) **By export orientation**: Export-intensive firms reduced 1 per cent of their net fixed assets, while non-exporters largely halted capital expenditure.
- (iii) **By sector**: Transport equipment manufacturers showed robust capex relative to their NFA following an uncertainty shock. Manufacturers of light-tech products, such as leather (0.79 per cent of NFA), beverages (0.62), wood products (0.42), and rubber and plastics (0.17), registered moderate capital expenditure improvements amidst uncertainty. In contrast, technology-intensive firms, such as machinery (-0.49) and electrical equipment (-0.46), registered a moderate decline in capital expenditures following an uncertainty shock. Even so, other tech-intensive sectors such as chemicals (0.06) and pharmaceutical manufacturers (0.21) displayed consistent investment despite an uncertainty shock.

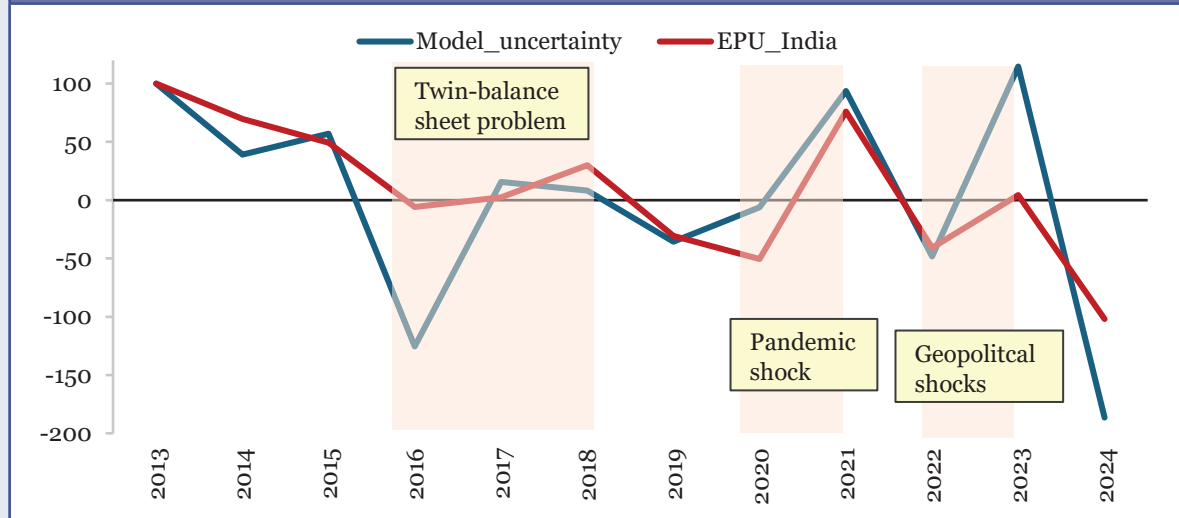
Services sector firms within categories such as civil engineering (8.51), consultancy (0.33), advertising (0.28), and retail trade (0.26) showed healthy capital expenditure following a shock.

As a robustness check, the uncertainty shocks reported by the model are compared to the EPU index for India between 2010 and 2024. The chart below illustrates the changes in uncertainty shocks and the corresponding changes in the EPU over time.²⁰ The two measures show a good degree of correlation (78 per cent). Both measures spike during the years of the twin balance sheet problem (2016-2018), the pandemic years (2020-2021) and in the presence of heightened geopolitical shocks (2022-2023). This shows that the model correctly gauges uncertainty before estimating its impact on capital formation across firms.

¹⁹ Firms are separated based on size, depending on their relative ranking (amongst other listed firms) in terms of assets and sales over the past three years.

²⁰ While the EPU measures policy-related uncertainty, the model's estimates reveal the uncertainty experienced by firms. It may be noted that while policy uncertainty may be a sufficient condition for firms to experience uncertainty, it is not a necessary condition, i.e., firms may experience uncertainty shocks in the absence of policy uncertainty. For instance, a sectoral demand shock may trigger an uncertainty response for firms even in the presence of a stable policy environment.

Chart III.2: Variations in EPU and model estimates of uncertainty (indexed to 100 for 2013)



Source: Author's calculations.

Inferences

In the absence of causality testing that accounts for other firm attributes, no inference can be made regarding the relationship between asset size and firm uncertainty. Nevertheless, the correlation between firm size and capital formation indicates that mid-sized firms in the sample were more vulnerable to uncertainty shocks than firms in the top or bottom deciles of the asset distribution. This may be because large firms can absorb shocks using internal resources, while small firms can leverage their agility to continue investing despite uncertainty. Mid-sized firms, in contrast, lack both the flexibility of small firms and the resource buffer of large ones.

As most of the shocks observed between 2010 and 2024 were of a global nature, the model indicated that exporter firms are more likely to reduce capital formation in the presence of an uncertainty shock compared to their domestic counterparts.

The impact of uncertainty is heterogeneous at a sectoral level. Traditional and medium-technology sectors displayed continued capital formation despite an uncertainty shock. The services sector, too, broadly held up to an uncertainty shock, as evidenced by sectors such as civil engineering, consultancy, and market research. In contrast, high-tech manufacturing firms, barring a few exceptions, cut back on capital formation. This is evidenced by the literature, which shows that manufacturing firms tend to experience intense uncertainty due to factors such as long gestation periods, higher irreversibility, and input supply disruptions.²¹

²¹ See, for instance, Mohades Forooshani, S. S., Piccillo, G., & Treibich, T. (2024). Unpacking Economic Uncertainty: Measuring the Firm, Sector and Aggregate Components. CESIFO WORKING PAPERS, 10974, <https://tinyurl.com/z9kjfpwd>; Bar-Ilan, A., & Strange, W. C. (1996). Investment lags. *The American Economic Review*, 86(3), 610-622, <https://tinyurl.com/4tj4j8nn>; and Castelnovo, E., Tuzcuoglu, K., & Uzeda, L. (2022). Sectoral uncertainty, <http://dx.doi.org/10.2139/ssrn.4259631>.

Policy approaches aimed at reviving private capital formation must therefore explicitly account for uncertainty and its uneven sectoral effects, specifically for sectors that intensely experience uncertainty shocks. Reviving private capital expenditure in such areas requires buffering sector-specific uncertainty by enhancing predictability through deregulation and simpler, more stable laws and frameworks.

MONETARY DEVELOPMENTS

3.9 India's approach to monetary management balances macroeconomic objectives with social goals. By maintaining price stability, supporting financial stability, and promoting inclusive growth, monetary policy acts as a key enabler of sustainable development and economic prosperity in the country.

3.10 In the light of the evolving macroeconomic and financial developments outlined in the previous section, the RBI undertook several key monetary policy actions in FY26 (April-December). These measures were designed to support economic growth while maintaining price stability. In response to the easing inflation, the RBI's Monetary Policy Committee (MPC) cumulatively reduced the repo rate by 100 basis points during its meetings from April to December 2025. As of December 2025, the repo rate stands at 5.25 per cent. These reductions were aimed at boosting credit flow, investment, and overall economic activity. Furthermore, in consideration of the prevailing and expected inflation-growth dynamics, the MPC's stance was changed from accommodative to neutral in June 2025. This neutral stance has been consistently maintained since then, allowing the MPC the flexibility to respond to economic conditions as necessary.

3.11 The RBI also announced a 100-bps reduction in the cash reserve ratio (CRR) to 3.0 per cent of net demand and time liabilities, implemented in a staggered manner during September-November 2025. This decision is expected to release approximately ₹2.5 lakh crore in primary liquidity into the banking system by December 2025.²²

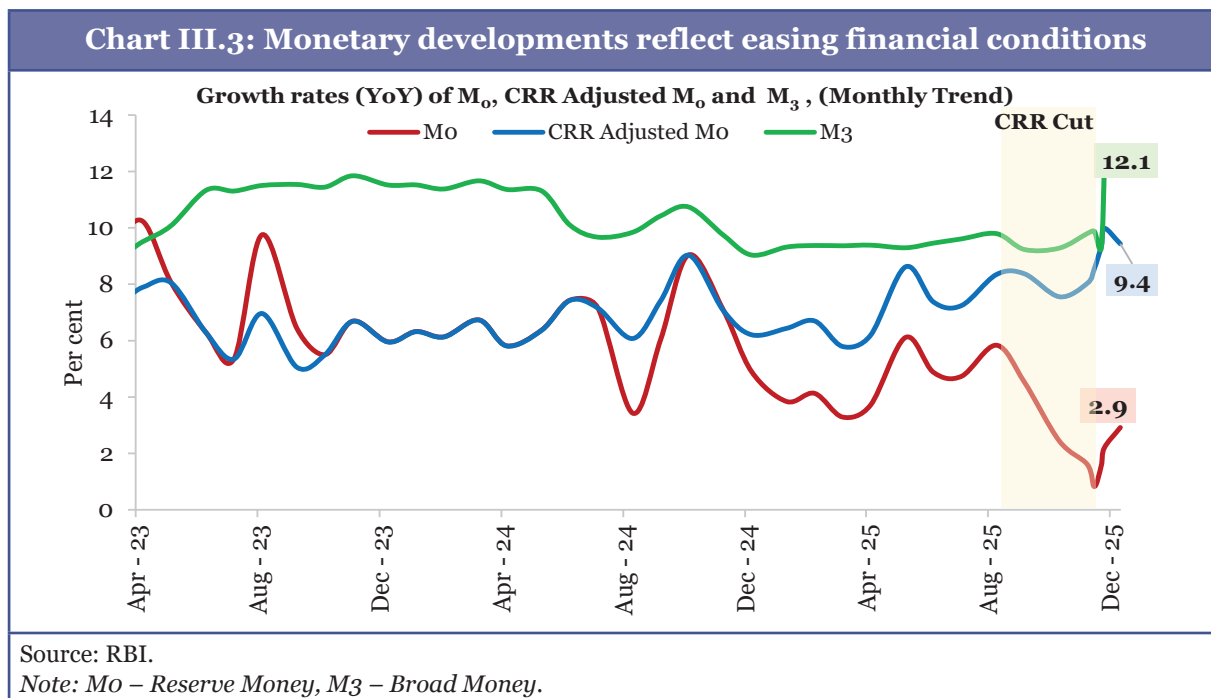
3.12 The trends in the monetary aggregates reflect the impact of the RBI's policy actions on the economy. As of 31 December 2025, the reserve money (Mo) growth,²³ i.e., the monetary base, stood at 2.9 per cent, compared to 4.9 per cent as of 27 December 2024. This declining trend does not signal a tightening of the liquidity conditions, since adjusted for the first-round impact of the change in the CRR,²⁴ the Mo growth stood at 9.4 per cent, compared to 6.2 per cent a year ago. Therefore, the declining trend reflects

²² RBI's press release dated 6 June 2025, 'Governor's Statement', <https://tinyurl.com/ymx7rsdy>.

²³ On the component side, Reserve Money (Mo) = Currency in circulation + Banker's deposits with RBI + Other deposits with RBI.

²⁴ CRR was cumulatively reduced by 125 bps during December 2024-November 2025.

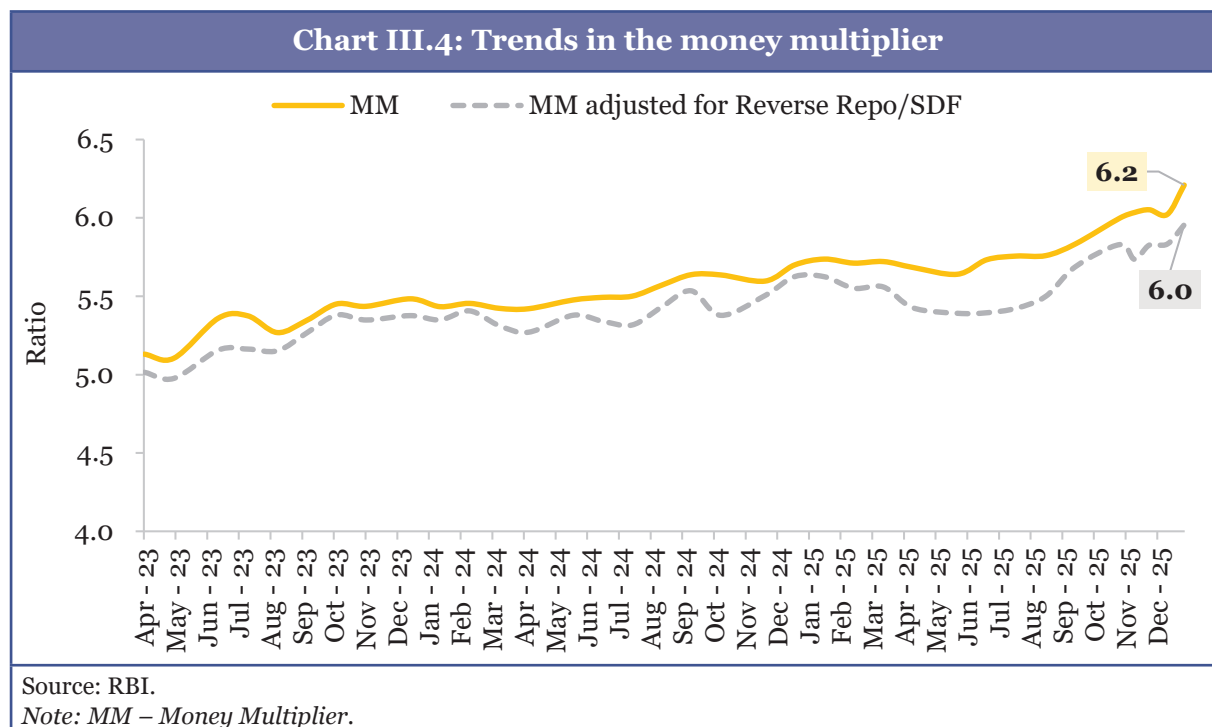
the impact of the CRR cut, which led to a reduction in bankers' deposits with the RBI, resulting in a decline in the growth of reserve money. The CRR-adjusted Mo reflects the true expansionary stance of monetary policy. On the component side, the currency in circulation expanded by 10.2 per cent as of 31 December 2025 compared to 5.9 per cent on 27 December 2024.



3.13 During the same period, broad money (M₃) growth, including the impact of the merger of a non-bank with a bank (with effect from 1 July 2023), was 12.1 per cent, as compared with 9 per cent a year ago. This trend in the broad money growth indicates that the banks have effectively leveraged the liquidity released by the CRR cut. In terms of components, aggregate deposits with banks, which are the largest component of M₃, were the primary drivers of M₃'s growth. Notably, the aggregate deposits with the banks grew by 12.3 per cent (YoY). On the sources side,²⁵ bank credit to the commercial sector was a major contributor to the increase in M₃, growing by 14.1 per cent (YoY).

3.14 As of 31 December 2025, the money multiplier (MM), i.e., the ratio of M₃ to M₀, stood at 6.21 vis-à-vis 5.70 a year ago. When adjusted for the reverse repo/standing deposit facility (SDF), which is analytically akin to bankers' deposits with the central bank, the adjusted MM stood at 6.0. The upward trajectory of the MM indicates improved financial intermediation by the banking system, thereby ensuring adequate systemic liquidity.

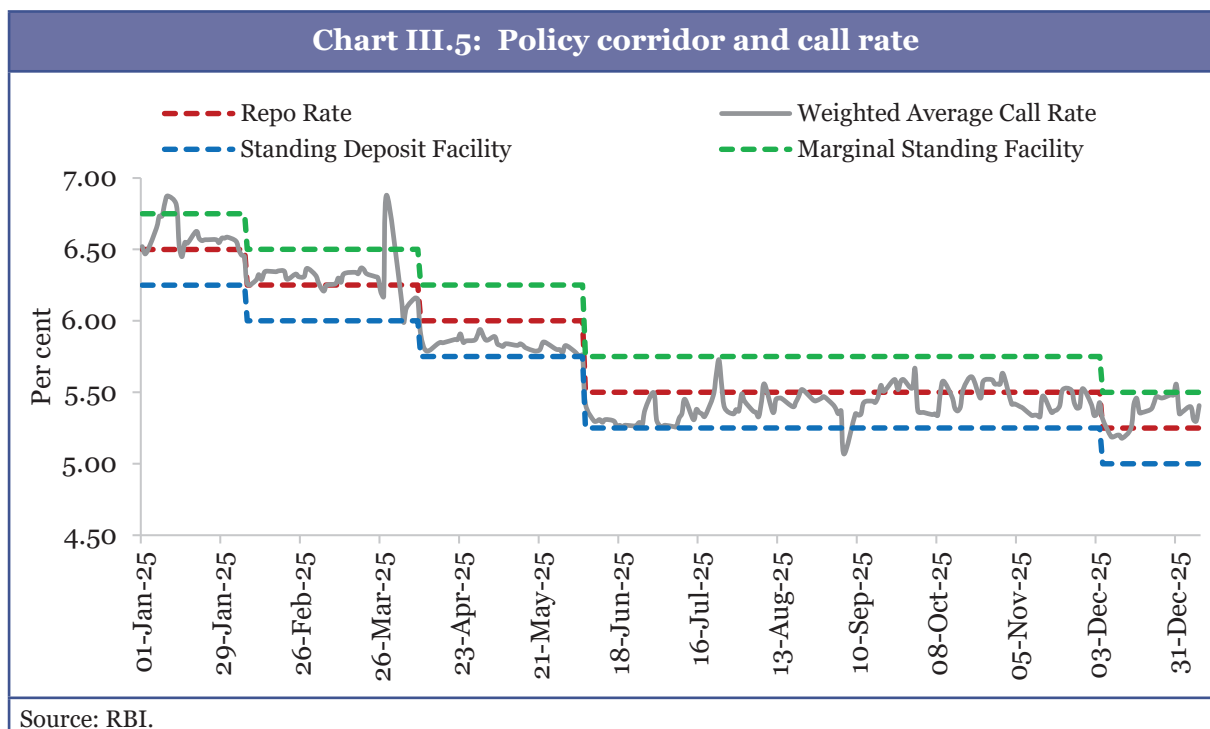
²⁵ Sources of Broad Money = Net Bank Credit to Government + Bank Credit to Commercial Sector + Net Foreign Exchange Assets of Banking Sector + Government's Currency Liabilities to the Public - Net Non-Monetary Liabilities of the Banking Sector.



Liquidity Conditions

3.15 Along with the 100-bps cut, the RBI also injected durable liquidity of ₹2.39 lakh crore through nine Open Market Operations (OMO) purchases during April-May 2025. Furthermore, in light of the evolving liquidity conditions and outlook, the RBI conducted OMO purchases of ₹1 lakh crore and a 3-year USD/INR buy-sell swap of USD 5 billion in December to inject durable liquidity into the system. As a result, system liquidity, as measured by the net position under the liquidity adjustment facility (net LAF), was on average in surplus of about ₹1.89 lakh crore during FY26 (up to 8 January 2026), significantly higher than ₹1,605 crore in FY25. Reflecting surplus liquidity conditions, banks' recourse to the marginal standing facility (MSF) declined while their deployment of surplus funds under the SDF increased. Borrowings under the MSF declined to an average of ₹2,244 crore in FY26 (as of 8 January 2026) from ₹6,902 crore in FY25. Concomitantly, the deployment of funds under the SDF increased to an average of ₹1.74 lakh crore in FY26 (up to 8 January 2026) as compared with ₹0.94 lakh crore in FY25.

3.16 Throughout FY26, the RBI remained agile in its liquidity management, ensuring that adequate liquidity was maintained in the banking system. This proactive approach facilitated effective transmission to the money and credit markets, meeting the economy's productive requirements. As a result, the weighted average call rate, which serves as the operating target of monetary policy, generally remained below the policy repo rate during FY26, averaging 8 basis points below it (up to 8 January 2025).



3.17 Monetary policy transmission to lending and deposit rates of scheduled commercial banks (SCBs) has been robust amid surplus liquidity conditions. In response to the 100-bps cumulative cut in the policy repo rate, the weighted average lending rates (WALR) of the SCBs declined. During April–November 2025, the WALR of SCBs on fresh rupee loans decreased by 64 basis points, standing at 8.71 per cent in November 2025. Similarly, the WALR of SCBs on outstanding rupee loans has decreased by 56 basis points over the same period, standing at 9.21 per cent in November 2025, reaching its lowest level recorded since September 2022.

FINANCIAL INTERMEDIATION

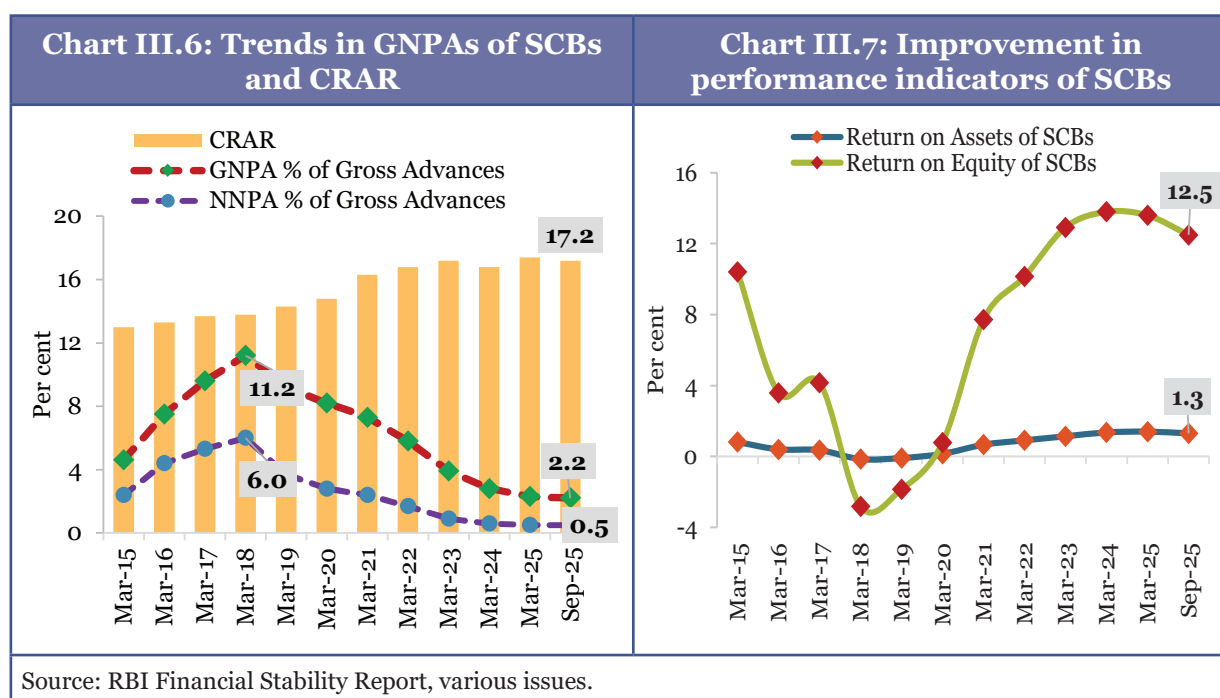
3.18 Financial intermediaries implement monetary policy by transmitting the central bank’s decisions on interest rates, liquidity management, and credit supply to the real economy. Central banks set policy rates and conduct market operations, while financial intermediaries adjust lending and deposit rates, influencing spending, investment, inflation, and financial stability.

3.19 Financial intermediation in the Indian economy is carried out by a diverse set of institutions, including banks, non-banking financial companies (NBFCs), microfinance institutions (MFIs), capital markets, and digital fintech platforms. These entities mobilise savings, channel credit, manage risks, and enable efficient transactions, thereby bridging the gap between savers and borrowers. The country’s financial intermediation landscape has undergone rapid digital transformation, with innovations such as the

Unified Payments Interface (UPI), Aadhaar-enabled services, and AI-driven credit scoring expanding access to financial services, particularly in rural and underserved areas. This section discusses the trends in the functioning of various intermediaries and regulatory developments.

Performance of the banking sector

3.20 The stability of the banking system in the country can be attributed to strong capital buffers, low non-performing asset ratios (NPAs), and increasing profitability. The favourable balance sheets of the SCBs bode well for the overall health of the economy. A significant improvement has been observed in the asset quality of SCBs, as evidenced by their gross non-performing asset (GNPA) ratio and net NPA ratio, having reached a multi-decadal low level and record low level, respectively. At the same time, the capital-to-risk-weighted-asset ratio (CRAR) of the SCBs remained strong at 17.2 per cent as of September 2025.

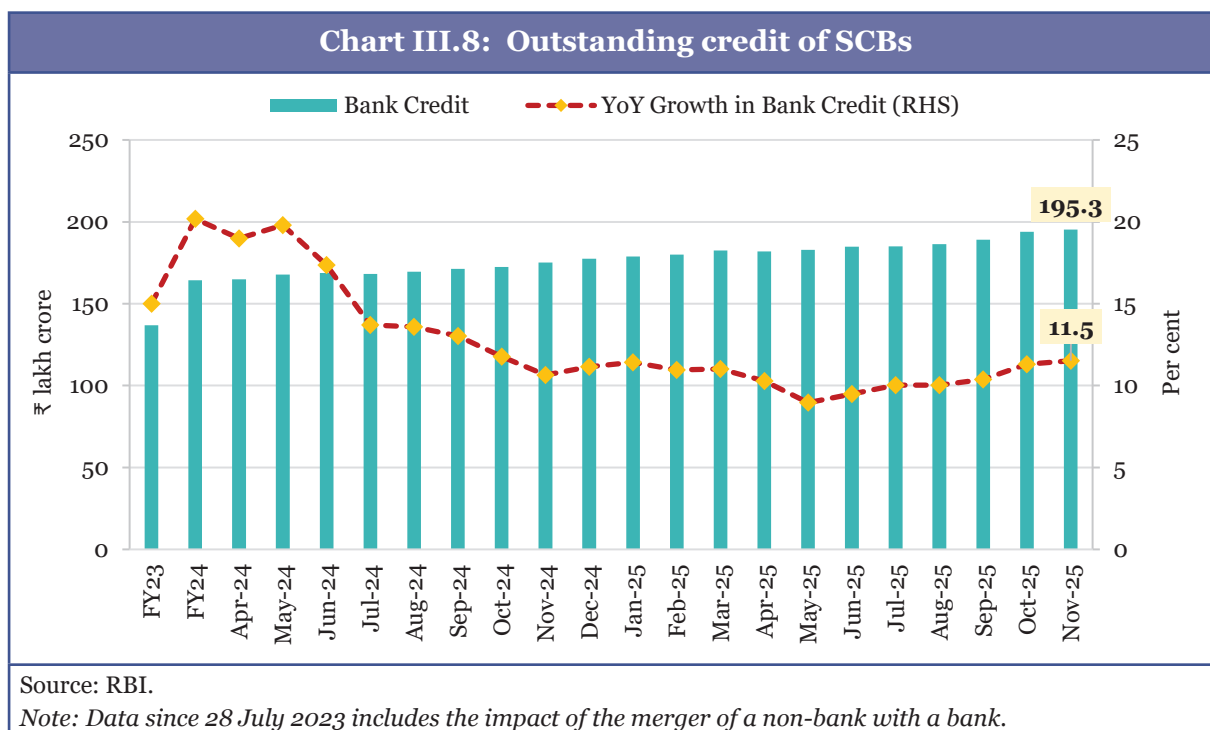


3.21 Furthermore, this improvement in asset quality has been observed across broad economic sectors. The GNPA ratio for the industry decreased from 2.3 per cent in March 2025 to 1.9 per cent in September 2025. For services, the ratio decreased from 2.0 per cent to 1.8 per cent, and for personal loans, it decreased from 1.2 per cent to 1.1 per cent. In contrast, the GNPA ratio for the agriculture sector remains relatively higher at 6.0 per cent in September 2025 and has improved marginally from 6.1 per cent in March 2025. However, the share of this sector in total GNPA has increased from 34.6 per cent to 36.3 per cent over the same period.

3.22 The recovery rate in NPAs²⁶ in SCBs has approximately doubled from 13.2 per cent in FY18 to 26.2 per cent in FY25. The slippage ratio of SCBs, which measures the amount of new accretion to NPAs during the FY as a percentage of standard loans and advances as at the beginning of FY, has also improved from 7.1 per cent in FY18 to 1.4 per cent in FY25 and further to 1.3 per cent in FY26, as of September 2025. The recovery rate through the Insolvency and Bankruptcy Code, 2016 (IBC/Code) has improved from 28.3 per cent in FY24 to 36.6 per cent in FY25. Through the SARFESI, it has improved from 25.4 per cent in FY24 to 31.5 per cent in FY25.

3.23 Concurrently, the profitability metrics of SCBs are as follows. Their profit after tax increased by 16.9 per cent (YoY) in FY25 and by 3.8 per cent (YoY) by September 2025. The return on equity for SCBs has experienced a marginal decline from 13.8 per cent in March 2024 to 13.6 per cent in March 2025; however, it has maintained a steady upward trend since March 2020. On the other hand, the return on assets has remained stable at 1.4 per cent in March 2025, consistent with the level recorded in March 2024. As of September 2025, these metrics stand at 12.5 per cent and 1.3 per cent, respectively.

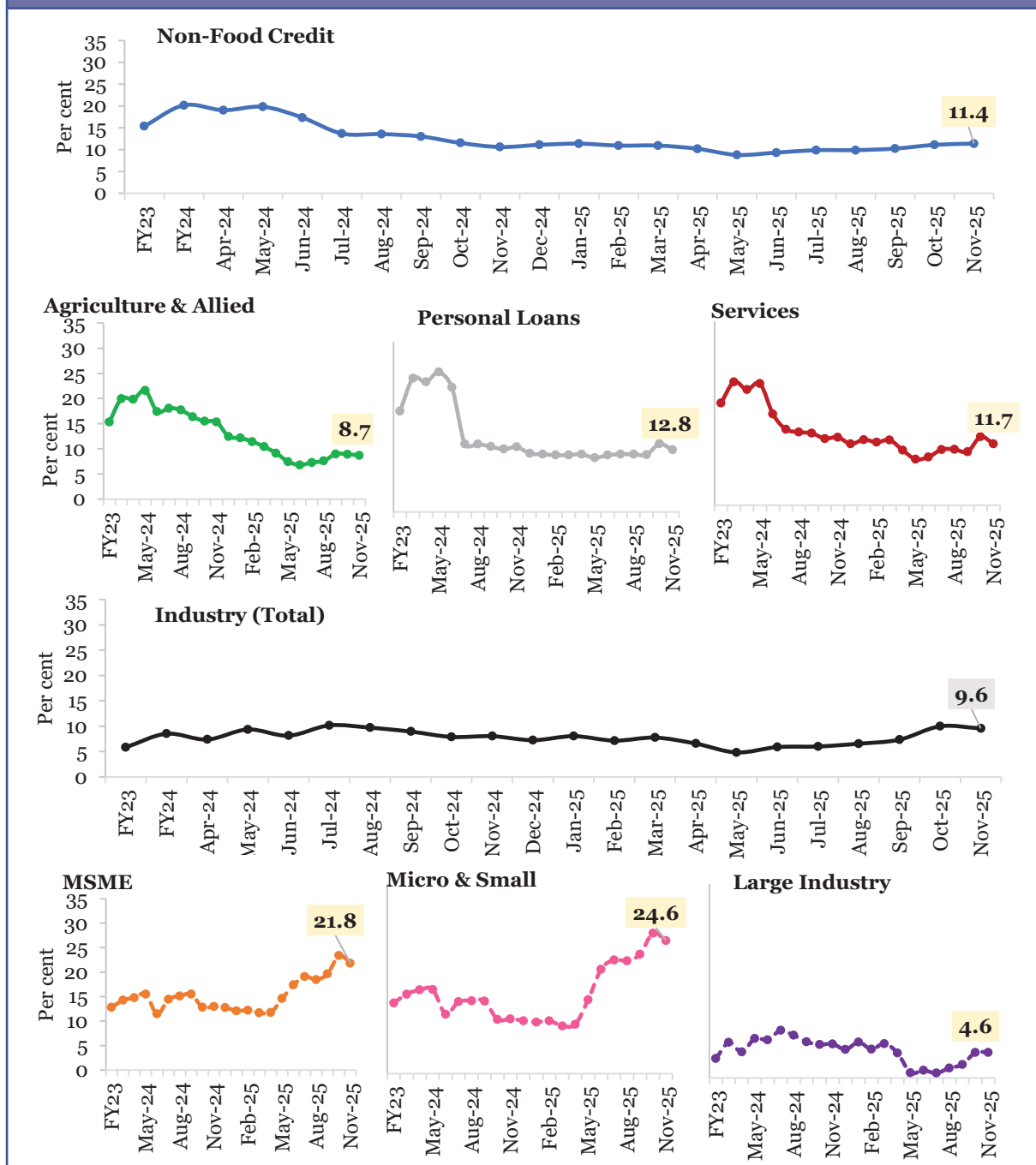
3.24 In FY26, a moderation in bank credit growth was observed across major sectors compared to the same period last year, though recent months have shown an uptick. As of 31 December 2025, the (YoY) growth in outstanding credit by SCBs increased to 14.5 per cent compared to 11.2 per cent in December 2024. December 2025 marked the highest YoY growth rates for both bank credit and non-food credit in FY26 (up to December 2025).



²⁶ Recovery rate in NPAs in SCBs is calculated as the aggregate recovery made by public sector banks in NPAs, including written-off loans as a percentage of gross NPAs at the beginning of FY.

3.25 In terms of sectoral deployment of non-food credit, among the categories of agriculture and allied activities, industry, services and personal loans, the highest YoY growth has been observed in personal loans, with an increase of 12.8 per cent in November 2025. A significant factor contributing to this growth is a substantial rise in loans against gold jewellery, which have increased by 125.3 per cent (YoY), likely due to the increasing prices of gold.

Chart III.9: Sectoral deployment of non-food credit of SCBs (YoY growth)



Source: RBI.

Note: Data since 28 July 2023 includes the impact of the merger of a non-bank with a bank.

3.26 While the YoY growth trend in credit for industry and services has demonstrated a moderate increase in FY26 thus far, within industry, the bank credit to the MSME sector continues to show momentum and remains robust. In November 2025, bank credit to this sector increased by 21.8 per cent compared to a 13 per cent increase in November 2024. Within the MSME sector, the credit extended to the micro and small enterprises has registered an increase of 24.6 per cent (YoY) in November 2025, up from 10.2 per cent in November 2024.

3.27 Certain regulatory measures, such as revised guidelines on voluntary pledge of gold and silver jewellery as collateral for small business loans, have helped in improving credit flow to the MSME segment. Furthermore, measures announced in the Union Budget 2025-26, such as a significant enhancement of credit availability with guarantee cover for MSMEs, the introduction of credit cards for micro-enterprises, and others, have also been beneficial to the sector. The revision in MSMEs classification, wherein investment limits and turnover thresholds have been substantially raised, also contributed to this high growth.^{27,28}

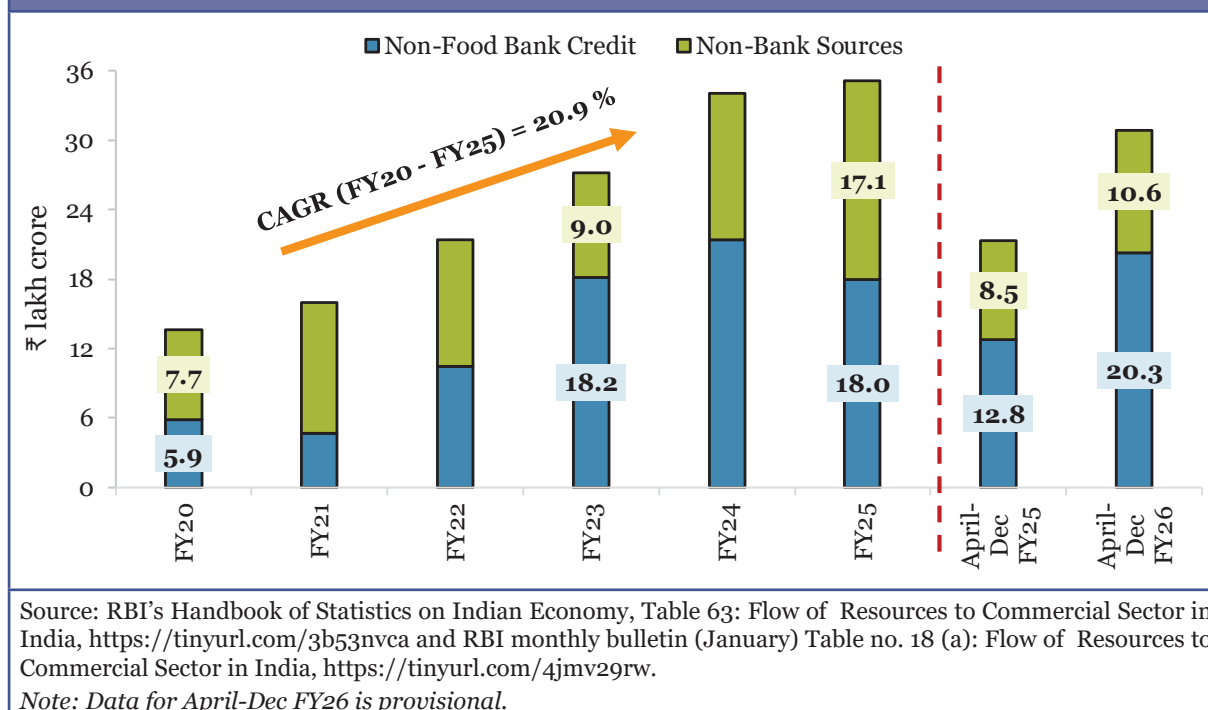
3.28 Between FY20 and FY25, there has been a notable increase in the overall flow of resources to the commercial sector, demonstrating a compounded annual growth rate (CAGR) of 20.9 per cent. This flow has increased from ₹13.6 lakh crore in FY20 to ₹35.1 lakh crore in FY25.²⁹ This upward trend has continued into FY26, with the overall flow of resources to the commercial sector amounting to ₹30.8 lakh crore in April-December 2025, registering an increase of 44.7 per cent (YoY).

3.29 As of 31 December 2025, within the overall flow of financial resources to the commercial sector, there has been an increase in the flow from non-bank sources, which have risen by 23.8 per cent (YoY), while the non-food bank credit has experienced a growth of 58.6 per cent (YoY).

²⁷ Union Budget 2025-26, <https://tinyurl.com/2s4ed4c9>.

²⁸ RBI Monetary Policy Report, October 2025, <https://tinyurl.com/2rj4mwzm>.

²⁹ RBI's Handbook of Statistics on Indian Economy, Table 63: Flow of Resources to Commercial Sector in India, <https://tinyurl.com/3b53nvca> and RBI monthly bulletin (January) Table no. 18 (a): Flow of Resources to Commercial Sector in India, <https://tinyurl.com/4jmv29rw>.

Chart III.10: Overall flow of resources to the commercial sector in India


3.30 Further within the non-bank sources, foreign sources have experienced a greater YoY increase as compared to the domestic sources. In FY26, as of 31 December 2025, while the former have experienced a growth of 38 per cent, the latter have experienced a growth of 19.1 per cent (YoY). The increase in foreign sources is driven primarily by a significant rise in external commercial borrowings by non-financial entities, which increased from ₹5 thousand crore to ₹27.7 thousand crore, and foreign direct investment (FDI) to India, which increased by 67 per cent (YoY). The increase in domestic sources is mainly attributable to a rise in the corporate bond issuances by non-financial entities, which have experienced a 263.3 per cent (YoY) growth. The foregoing discussion highlights the banking sector's robust performance and resilience.

3.31 It is important to note that a concurrent increase in the flow of financial resources to the commercial sector, bolstered by greater non-bank intermediation, has accompanied the slowdown in bank credit growth in early FY26. This trend indicates that non-bank sources have effectively offset the decline in bank credit. The quicker transmission of monetary policy has made market-based financial instruments a feasible source of funding for large corporations. Furthermore, as the profitability of large corporations has risen over time, their internal resources have become a vital source for business expansion.³⁰ Collectively, these factors have led to a reduction in their demand for bank credit. Therefore, large corporations are increasingly turning to market-based

³⁰ RBI's Monthly Bulletin (August), 2025, <https://tinyurl.com/2x2yydj4>.

instruments to meet their funding requirements, while MSMEs primarily depend on bank credit to fulfil their funding needs.

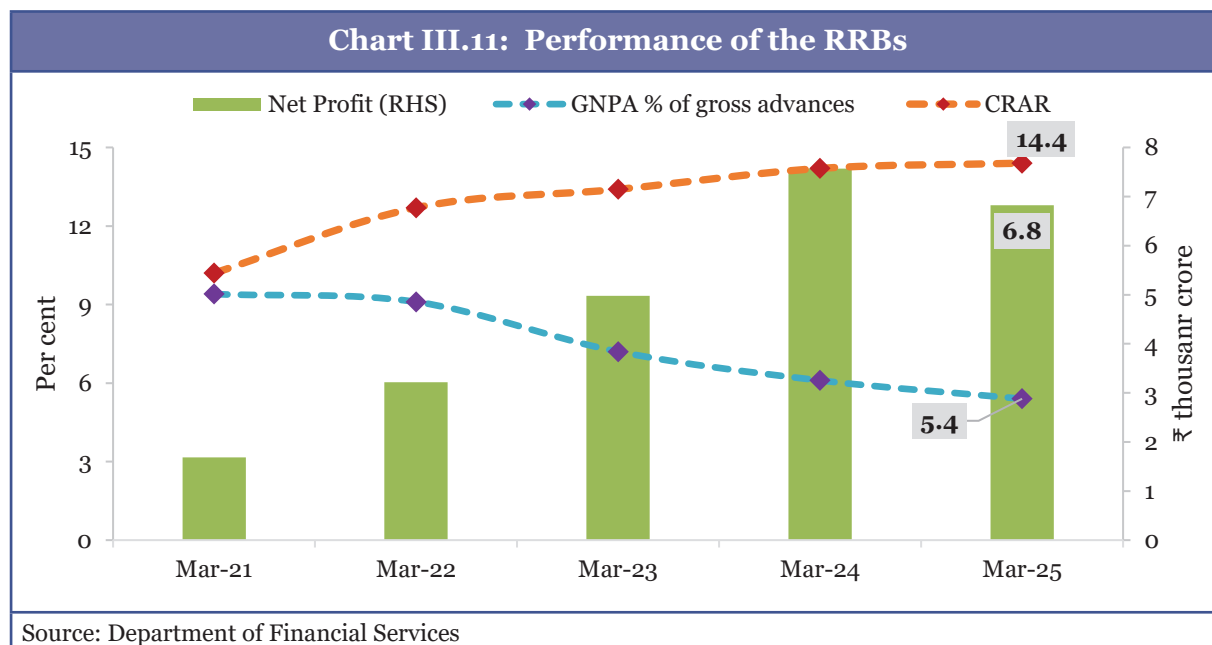
3.32 In rural and semi-urban areas, the financial intermediation is primarily conducted through Regional Rural Banks (RRBs). These banks provide an alternative channel for credit distribution to small and marginal farmers, agricultural labourers, and socioeconomically disadvantaged groups. Their main focus areas include agriculture, trade, commerce, and small-scale industries in rural regions. The following section reviews recent measures implemented to strengthen and streamline the RRB structure, as well as their evolving financial performance.

Performance of regional rural banks

3.33 The government undertook various measures to optimise the resources and enhance the performance of the RRBs, such as their consolidation in four phases based on the principle of One-State-One-RRB that reduced their number from 196 to 28 as of 1 May 2025. Furthermore, the integration of the Core Banking Solution and other IT systems of the amalgamated RRBs into unified platforms has been undertaken. To establish a unified brand and national identity of RRBs, a common logo has been adopted for all 28 RRBs.

3.34 Due to the above measures, their performance has improved significantly. In recent years, the financial health of the RRBs has improved. During FY24, they achieved a record consolidated net profit of ₹7.6 thousand crore, followed by a second-highest consolidated net profit of ₹6.8 thousand crore during FY25. This slight decline in profit can be attributed to the implementation of the pension scheme with retrospective effect from 1 November 1993, as well as the payments towards computer increment liability.³¹ Moreover, key financial indicators have shown consistent improvement. While the GNPA ratio for SCB in the agricultural sector remains relatively high, the asset quality of RRBs has shown notable improvement. The GNPA ratio, expressed as a percentage of gross advances, decreased from 6.1 per cent in FY24 to 5.4 per cent in FY25, reflecting the lowest level in the past 13 years.

³¹ Lok Sabha Unstarred Question no. 111 answered on 1 December 2025, <https://tinyurl.com/52n6ymcf>.



3.35 Additionally, credit expansion has contributed to an increase in the consolidated credit-to-deposit ratio, which rose from 71.4 per cent in March 2024 to 73.8 per cent as of March 2025, the highest level recorded in 35 years. Furthermore, the consolidated CRAR of all RRBs reached an all-time high of 14.4 per cent at the end of FY25. It is also noteworthy that RRBs have consistently exceeded the priority sector lending target of 75 per cent of their adjusted net bank credit over the years, underscoring their commitment to fulfilling their foundational objectives.

Major policy actions in the banking sector

3.36 A rise in global uncertainty and geopolitical volatility demands a stable and efficient domestic regulatory regime. The RBI has been committed to ensuring regulatory certainty and efficiency over time. In this context, its recent measures aimed at enhancing these aspects within the banking sector are timely and significant.

3.37 The RBI issued a policy statement on ‘Framework for Formulation of Regulations’ on 7 May 2025 with an objective to standardise the process of making regulations in a transparent and consultative manner after conducting impact analysis, as may be feasible. It also stipulates a periodic review of regulations, taking into account the stated objectives, experience gained through surveillance and supervision, relevant court orders, global best practices or standards prescribed by international standard-setting bodies, the relevance in a changing environment, and the scope for reducing redundancies.

3.38 The public sector banks (PSBs) have launched the credit assessment model (CAM)

based on the digital footprints³² for MSMEs in 2025. This model will leverage digitally fetched and verifiable data to enable automated loan appraisal for MSMEs, utilising objective decisioning for all loan applications and model-based limit assessment for both existing-to-bank and new-to-bank MSME borrowers. Along with improving the ease of doing business for the MSMEs, this model also integrates the credit guarantee schemes, such as the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE). Between 1 April and 30 November 2025, over ₹3.2 lakh crore MSME loan applications, amounting to more than ₹41.5 thousand crore, have been sanctioned by PSBs under the credit programmes of CAM.

3.39 RBI has also initiated a significant reorganisation of its regulatory instructions, a move that signifies a transformative change in its regulatory communication. This comprehensive effort involved consolidating over 9,000 existing circulars and guidelines into 238 function-specific Master Directions, tailored for distinct categories of regulated entities. Additionally, instructions issued by NABARD to RRBs, State Cooperative Banks, and Central Cooperative Banks were also consolidated in consultation with NABARD. As part of this initiative, the central bank will repeal 9,446 circulars, of which 3,809 have been incorporated into Master Circulars, while the remaining 5,673 have been deemed obsolete. This exercise aims to enhance clarity and accessibility while reducing the compliance burden on regulated entities, ultimately supporting the overarching objective of improving the ease of doing business.³³

3.40 To strengthen the institutional mechanism for review of regulations, the RBI has constituted a regulatory review cell with a mandate to review every regulation in a comprehensive, objective, and systematic manner, at least once every 5-7 years. The cell has been operationalised effective from 1 October 2025. Furthermore, to strengthen stakeholder engagement in the regulatory process and leverage industry expertise continuously, an independent Advisory Group on Regulation comprising external experts has been established.

3.41 Within the strengthened regulatory governance architecture, the RBI has also articulated principle-based guidance for the use of AI. It has introduced a Free AI framework for responsible AI, which is designed to foster financial innovation while ensuring robust risk management. In this context, Box III.2 discusses the details of the framework as well as cross-country usage of AI by central banks.

³² Digital footprints are used by the model for know your customer (KYC) authentications, mobile and email verifications. GST data analysis, bank statement analysis (using account aggregator), ITR verification and due diligence using credit information companies' data, fraud checks, among others.

³³ RBI Press release dated 28 November 2025: Reserve Bank of India issues Consolidated Master Directions, <https://tinyurl.com/5n6wpw5h>.

Box III.2: Artificial Intelligence in financial services: Global trends and India's approach.

Globally, the adoption of AI in finance is accompanied by parallel developments in international policy. The World Economic Forum's white paper on AI in Financial Services (January 2025) projects that investments across banking, insurance, capital markets and payments business will reach USD 97 billion by 2027, with AI making substantial contributions to revenue growth in the forthcoming years through enhanced operational efficiency, accuracy and a higher degree of personalisation at scale.³⁴ Further, the AI-powered alternative credit scoring models promote financial inclusion, particularly in developing economies.

There is a convergence in priorities among central banks as they adopt AI, which includes using AI to enhance decision-making, improve operational efficiency, and manage risks effectively. However, there is a notable difference in their adoption of specific AI initiatives. The use of AI by a few central banks is discussed below:

The European Central Bank utilises AI to enhance statistics for monetary policy, supplement data with sources such as text and images using large language models, and for nowcasting and forecasting inflation. It also developed early warning models to identify financial risks. It created innovative payment services, such as voice-activated payments, to promote financial inclusion and enhance communication, thereby ensuring a better understanding of policies and inflation expectations.³⁵ The Federal Reserve's Federal Open Market Committee has adopted AI for tasks such as writing, coding and research to enhance the analytical capabilities and gain insights into the broader implications of AI.

This approach has helped the Fed understand both the benefits of AI and identify its limits, as well as areas where its use requires caution.³⁶ The Bank of Canada has primarily adopted AI to forecast inflation, economic activity, and the demand for banknotes. It also tracks the sentiments in key sectors of the economy using sentiment analysis.³⁷ The Bank of England has forecasted service inflation using a machine learning model, as well as to predict financial crises and bank distress.^{38,39}

These AI applications pose risks of unintended outcomes and ethical issues. Policymakers respond with various regulations, including principles, voluntary measures, and laws. The

³⁴ World Economic Forum: White Paper - Artificial Intelligence in Financial Services, January 2025, <https://tinyurl.com/39n2ttap>.

³⁵ Keynote speech by Piero Cipollone, Member of the Executive Board of the European Central Bank, at the National Conference of Statistics on official statistics at the time of artificial intelligence, dated 4 July 2024: <https://tinyurl.com/ec23snp3>.

³⁶ Speech by Governor Lisa D. Cook at the National Bureau of Economic Research, Summer Institute 2025: Digital Economics and Artificial Intelligence, Cambridge, Massachusetts, dated July 17 2025: <https://tinyurl.com/ywrd4ana>.

³⁷ Remarks by Tiff Macklem, Governor of the Bank of Canada, at the National Bureau of Economic Research, Economics of Artificial Intelligence Conference, dated 20 September 2024: <https://tinyurl.com/46recz49>.

³⁸ Bank of England's Monetary Policy Report, May 2025: <https://tinyurl.com/4y6ke639>.

³⁹ Speech by James Benford TRUSTED AI: Ethical, safe, and effective application of artificial intelligence at the Bank of England: <https://tinyurl.com/mryjwas4>.

EU has developed a comprehensive AI framework through the EU AI Act, providing uniform rules and risk-based classification. Singapore adopted a multi-stakeholder approach for responsible AI in fintech, ensuring ethical compliance. The UK and US are relying on guidance frameworks, letting sector regulators adjust rules as needed.

Despite these diverse approaches, a shared objective emerges to ensure that AI enhances the provision of financial services in a safe and inclusive manner. These global developments provide important context and benchmarks for India's trajectory in governing AI in the finance sector.

India: RBI's FREE-AI Framework for Responsible AI⁴⁰

India's approach to adopting AI in financial services aligns with the broader goal of leveraging technology for inclusive economic development. The country's unique digital public infrastructure lays a foundation for AI integration, aiming to democratise financial access at an unprecedented scale.

Based on detailed surveys, the RBI found that AI adoption in Indian finance is still in its early stages, with only approximately 21 per cent of surveyed banks and financial institutions implementing or developing AI solutions. Adoption is concentrated among larger banks, while smaller urban cooperative banks and many NBFCs face resource constraints, including inadequate data infrastructure, limited skilled talent, and insufficient IT budgets. Additionally, even among early adopters, the use of AI applications remains basic, often focusing on improving process efficiency, customer interactions (such as simple chatbots), lead generation, and internal decision support, rather than engaging in complex autonomous decision-making.

The RBI's FREE-AI is designed to foster innovation while ensuring robust risk management, highlighting that these two elements are complementary forces that should be pursued together. The framework also supports the India AI Mission, enhancing national AI capabilities, and aligns with the Digital Personal Data Protection Act, ensuring consistency in data governance.

The RBI's framework recognises the importance of trust in mitigating systemic risks and preserving consumer confidence. It identifies seven core guiding principles, referred to as the 'Seven Sutras', to ensure effective AI development, deployment, and governance within the financial sector. These are (i) Trust; (ii) People First; (iii) Innovation over restraint; (iv) Fairness and equity; (v) Accountability; (vi) Understandable by design; (vii) Safety, resilience and sustainability.

Guided by these principles, the RBI's FREE AI outlines six strategic pillars for effectively implementing its vision. Under the Innovation Enablement Framework, the focus is on Infrastructure, Policy, and Capacity Building. This includes developing shared data and technology infrastructure to democratise AI access (for example, data lakes or plug-and-play 'landing zones' platforms that smaller firms can leverage), crafting agile policies and

⁴⁰ Source: RBI FREE-AI Committee Report: <https://tinyurl.com/y9sev5a6>.

establishing regulatory sandboxes for safe and controlled experimentation, along with addressing the AI skill gap. The Risk Mitigation Framework focuses on Governance, Protection, and Assurance to create transparent governance structures (like board oversight and ethics committees), implement robust protective measures for privacy and security, and mandate ongoing monitoring and validation of AI systems to ensure reliability.

The pillars of the framework provide a structured approach for financial regulators and institutions to leverage the benefits of AI while managing associated risks. At the same time, this position puts India as a leader in AI governance and presents a model for emerging economies, effectively balancing innovation with social responsibility.

Microfinance and financial inclusion

3.42 India's microfinance sector represents a key channel for advancing grassroots development in the country. With 95 per cent women borrowers and 80 per cent rural clientele, the sector addresses segments where credit access has historically been limited.

3.43 The sector operates through a diverse institutional structure. As of March 2025, NBFC-MFIs held 39 per cent market share by loan outstanding, followed by banks (32 per cent), small finance banks (16 per cent), NBFCs (12 per cent), and others (1 per cent). Microfinance operations span 685 districts across 28 states and 5 UTs, with the Eastern and Southern regions accounting for 62 per cent of the outstanding portfolio.⁴¹

3.44 Over the past decade, the microfinance sector has displayed steady growth, with active borrowers nearly doubling from 330 lakh in FY14 to 627 lakh in FY25. During this period, the gross loan portfolio of MFIs multiplied nearly seven times from ₹33,517 crore in FY14 to ₹2,38,198 crore in FY25. At the same time, MFI branch networks expanded from 11,687 branches to 37,380.⁴²

3.45 The microfinance sector experienced a reversal in growth in FY25, with loan outstanding declining by 14 per cent on a YoY basis. The stress reportedly appears to have been driven by credit overexposure in the sector, following a rise in pent-up demand after the pandemic period.⁴³ In response, the RBI, through its circular (dated 6 June 2025),⁴⁴ has taken a proactive measure by reducing the minimum qualifying assets mandated for microfinance from 75 per cent to 60 per cent of total assets for NBFC-MFIs. This is expected to enable NBFC-MFIs to manage their portfolio risks more effectively.⁴⁵ Critically, stringent guardrails were established by self-regulatory

41 Bharat Microfinance Report 2024-25, <https://tinyurl.com/yy3bsze4>.

42 Various Sa-Dhan reports across years, <https://tinyurl.com/ytm6pk9t>.

43 Ibid note 41.

44 RBI's notification: Review of Qualifying Assets Criteria dated 6 June 2025, <https://tinyurl.com/d4tr86vw>.

45 MFIN's Press Release on RBI's circular on "Review of Qualifying Assets Criteria" dated 9 June 2025, <https://tinyurl.com/ybwcuufyn>.

organisations (SROs)⁴⁶ in the form of reduced loan limits and caps on overall borrower indebtedness. In response to the prompt regulatory action, stress in the MFI sector has begun to temper with a reduction in risky assets on a quarterly basis between Q1 FY26 and Q2 FY26. Other indicators, such as loan disbursements and solvency ratios, showed a steady improvement across the same period.⁴⁷

3.46 Research suggests that MFIs face certain operational challenges, including the limited availability of a primary and standardised approach to assess household income. In the absence of alternative cash flow information, household income assessment may not always be fully accurate, and MFIs often rely on in-house estimation methods. However, this is likely to improve over time as more households come within the ambit of digital public infrastructure (DPI) and digital finance, which facilitates better generation and availability of cash flow information. MFIs are presently not seen to offer tailored credit with differential pricing for different categories. In some instances, lending may become more competitive when multiple MFIs serve the same borrowers, which may be symptomatic of deeper incentive structures within the MFI system. Box III.3 examines the incentive structures that may be contributing to the aggressive lending strategies employed by MFIs. They also often have little visibility over certain types of loans, such as gold loans, agricultural loans, and cooperative society credit. This can constrain their ability to calculate accurate repayment obligations of the borrower at the time of availing credit.⁴⁸

3.47 While the microfinance sector has evolved significantly over the past decade, its continued growth would hinge on strengthening enabling infrastructure (such as the tools to assess creditworthiness), ensuring responsible lending practices, and continuously strengthening institutional resilience to manage cyclical volatility.

Box III.3: Microfinance, financialisation, and the need to re-centre household welfare in impact investing

Microfinance has been a crucial component of India's financial inclusion strategy, particularly for low-income and rural households, as well as for women borrowers. The sector has expanded significantly over the past two decades, supported by institutional formalisation and the entry of private equity (PE) and venture capital (VC) investors. Commercial capital

⁴⁶ ASRO is an industry-led body that brings together market participants to enhance sector credibility, accountability, and governance. Self-regulation is intended to complement the existing regulatory and statutory framework, promoting compliance in both letter and spirit. To this end, SROs frame best practices, standards, and codes within the regulatory framework prescribed by the RBI for voluntary adoption by their members—these are not a substitute for the prescribed regulatory requirements for regulated entities. For more information, please refer - <https://tinyurl.com/3v3bdy7j>.

⁴⁷ Sa-Dhan. (2025). Quarterly Microfinance Report (July–September 2025), <https://tinyurl.com/ms6xn6u9>.

⁴⁸ Based on the findings by Dwara Research's report which derives from an extensive survey across the microfinance ecosystem, <https://tinyurl.com/bd8x6bz2>.

has enabled MFIs to scale operations, expand outreach, adopt technology, and integrate a large number of borrowers into the formal credit system. These gains to financial inclusion are substantial and merit recognition.

At the same time, the sector has experienced repeated episodes of stress, including over-lending, borrower over-indebtedness, and a rise in NPAs. These cycles indicate that rapid expansion of credit, when combined with strong financial-return expectations, can create vulnerabilities at both the institutional and household levels. They also raise a broader question about whether the growing financialisation of the sector has, in some contexts, weakened the original balance between social objectives and financial sustainability.

Microfinance was initially conceptualised as a model that aimed to improve household resilience, support income stability, and enable gradual asset accumulation. Over time, as MFIs became integrated into capital markets, their operating environment increasingly reflected the incentives associated with growth-oriented commercial investment. In such settings, portfolio expansion, yield metrics, and valuation outcomes may come to dominate strategic decisions, while social outcomes remain implicitly assumed rather than explicitly measured.

One outcome of this shift has been the use of scale-based ‘impact’ indicators, which are easier to report but are weakly connected to household welfare. These include metrics such as the number of borrowers reached, size of loan portfolios, share of women borrowers, or geographic spread. While useful for describing outreach, such indicators do not capture whether borrowers are better off in net terms. In practice, they can unintentionally reward more intensive lending, frequent top-ups, and deeper credit penetration, even in contexts where household repayment capacity is limited.

A more appropriate approach would require replacing such ‘impact-washing’ metrics with indicators that track household-level welfare and financial resilience over time. These could include measures of net asset accumulation, stability of cash flows, changes in savings balances, reduction in reliance on informal lenders, and incidence of distress borrowing during shocks. Tracking debt-to-income ratios, repayment burden perceptions, and volatility in household expenditure patterns would provide additional insight into whether microfinance is supporting long-term financial health rather than increasing net indebtedness.

Where such welfare-linked indicators are used, it becomes easier to identify circumstances in which credit expansion may be weakening household balance sheets. Existing empirical studies in India already document pockets of over-indebtedness in regions with high lender concentration and multiple borrowing.⁴⁹ Thus, excessive credit intensity, when not matched by robust credit appraisal and borrower capacity, can increase vulnerability and lead to repayment stress.

⁴⁹ LEAD at Krea University. (2020, January 6). Study on the drivers of over-indebtedness of microfinance borrowers in India: An in-depth investigation of saturated areas. IFMR-LEAD. <https://tinyurl.com/3sm4hh29>.

The alignment of investment incentives is closely related to this measurement challenge. Commercial capital has provided significant benefits in terms of institutional capacity, but PE/VC investment structures generally prioritise growth, profitability, and timely financial exits. As a result, investment performance is largely assessed through financial indicators, including portfolio growth, earnings milestones, and valuation appreciation. Social impact is stated as an objective, but its achievement is not always tied to investment outcomes in a systematic or verifiable manner.

A more consistent alignment between impact objectives and investor incentives would require linking exit decisions and valuations, at least partly, to the achievement of pre-specified social purpose metrics rather than exclusively to financial performance. For instance, investor exits could be conditioned on evidence of sustained household-level welfare gains, improved resilience indicators, or responsible credit intensity in borrower portfolios. Independent validation of such outcomes over a defined period would strengthen credibility and discourage growth strategies that prioritise scale at the cost of borrower sustainability.

This approach would also mitigate the risk that pressures to achieve time-bound exits lead to accelerated loan growth, expansion into riskier borrower segments, or a dilution of underwriting standards. Where exit readiness depends not only on financial metrics but also on demonstrable social outcomes, MFIs and investors would have stronger incentives to moderate expansion during periods of buoyant credit demand, focusing instead on portfolio quality, borrower capacity assessment, and complementary savings or insurance products.

From a policy standpoint, this realignment also has implications for the broader trajectory of financial inclusion. The experience of recent years suggests that inclusion defined primarily as access to credit may be fragile if not accompanied by improvements in household financial buffers. In some instances, easy access to frequent and repeated borrowing may displace precautionary savings and increase dependence on debt for smoothing routine expenditures. When repayment shocks occur, households may exit the formal credit system altogether, weakening the longer-term objective of inclusion.

Strengthening the resilience orientation of the sector would therefore require greater emphasis on household balance-sheet outcomes. This could include encouraging MFIs to integrate savings and risk-mitigation instruments alongside credit, improving borrower suitability assessments, and adopting data-driven mechanisms to detect emerging over-indebtedness. Impact measurement frameworks could also gradually transition from outreach-focused indicators to welfare-linked, household-level metrics, reported regularly and subject to independent review.

In summary, commercial capital has played an important role in expanding the reach and institutional capacity of India's microfinance sector. However, the incentives embedded in PE/VC investment structures have, in some contexts, encouraged financialisation and growth-driven expansion that may not always align with long-term household welfare. Re-centring the sector on its original social objectives will require replacing scale-based impact metrics with household-level welfare indicators and aligning investor exits and

performance evaluation with verified social outcomes alongside financial returns. Such an approach would strengthen the stability of financial inclusion gains and support the development of a more resilient and welfare-oriented microfinance ecosystem.

Financial inclusion – trends and structural drivers

3.48 India has made significant strides in financial inclusion over the past decade. For instance, the number of adults possessing a bank account doubled between CY 2011 (35 per cent) and CY 2021 (89 per cent).⁵⁰ There has also been a sharp narrowing in the gaps in financial access (between rich and poor, male and female) over the past decade. These structural shifts have been underpinned by two converging forces: regulatory innovation through India's digital infrastructure and government-led microfinance initiatives. Together, these drivers have expanded both the scale and depth of financial inclusion nationwide. The following section examines each factor in detail.

3.49 To advance financial inclusion, the government has introduced several targeted interventions. The Pradhan Mantri Jan Dhan Yojana (PMJDY), launched in CY 2014, has opened 55.02 crore accounts as of March 2025, with 36.63 crore in rural and semi-urban areas, establishing foundational savings and transaction infrastructure for previously unbanked populations. Building on this account base, credit-focused schemes have extended formal lending to underserved segments. The Stand-Up India Scheme offers bank loans ranging from ₹10 lakh to ₹1 crore to SC, ST, and women entrepreneurs for establishing greenfield enterprises. The PM Street Vendor's Atmanirbhar Nidhi (PM SVANidhi) scheme, launched in CY 2020, provides collateral-free working capital loans to street vendors. The Pradhan Mantri Mudra Yojana (PMMY), operational since April 2015, finances micro and small enterprises in manufacturing, trading, services, and allied agricultural activities. The operational experience of PMMY and PM SVANidhi provides empirical evidence on how graduated micro-credit delivery can foster financial inclusion, as examined in Box III.4.

Box III.4: Micro-Credit as a pathway to financial inclusion: Evidence from PMMY and PM SVANidhi

Government-led micro-credit initiatives have emerged as pivotal instruments in India's financial inclusion architecture, extending formal credit access to segments that have historically relied on informal sources of credit. PMMY and PM SVANidhi schemes exemplify this approach, targeting micro-entrepreneurs with collateral-free lending designed to seed enterprise formation, stabilise livelihoods, and foster graduation into higher credit tiers.

⁵⁰ World Bank Global Findex Database 2025, <https://tinyurl.com/5zw8b69n>.

PMMY, launched in April 2015 with the mandate to 'fund the unfunded', has achieved considerable scale. By October 2025, the scheme had disbursed over ₹36.18 lakh crore across 55.45 crore loan accounts. Significantly, more than 10 crore accounts belong to first-time borrowers, underscoring its catalytic role in bringing new entrepreneurs into the formal financial system rather than merely refinancing existing businesses. The scheme's tiered structure, Shishu (up to ₹50,000), Kishore (₹50,000-₹5 lakh), and Tarun (₹5 lakh-₹10 lakh), enables credit to grow in tandem with enterprise development. In October 2024, Tarun Plus (₹10 lakh-₹20 lakh) was introduced for repeat borrowers with strong repayment records, further institutionalising this graduation pathway. Over the past ten years, the share of Shishu accounts declined from 92 per cent to 63 per cent, while the Kishore and Tarun segments expanded, with average ticket sizes nearly doubling for Shishu loans and reaching above ₹7 lakh for Tarun. This compositional shift indicates a maturing borrower base that is progressively accessing larger credit facilities.

PM SVANidhi employs a similar graduated credit model for street vendors, a segment comprising individuals who were largely excluded from formal financial services. In CY 2023, the Indian School of Business (ISB) conducted an impact assessment of the PM SVANidhi scheme. Subsequently, a follow-up report was released, which covered 5,130 PM SVANidhi beneficiaries across 99 urban local bodies for the year CY 2025. The survey reveals a clear progression through loan cycles: while 51.5 per cent remain in the first cycle, 32.3 per cent have advanced to the second, and 16.1 per cent to the third, a marked shift from 2023, when almost all were first-cycle borrowers. This progression correlates with measurable business outcomes. The average annualised business income among SVANidhi borrowers increased by 20 per cent between 2023 and 2025, outperforming India's nominal GDP growth of 9-10 per cent, the MSME Gross Value-Added growth of 16.9 per cent, and the modest 5 per cent profit gains previously reported in microcredit studies. Growth varied by cycle: first-cycle borrowers recorded 17 per cent income growth compared with 23 per cent among second-cycle and 24 per cent among third-cycle borrowers. Borrowers who invested in fixed assets reported substantially faster income growth, 33 per cent compared to 16 per cent for those using loans solely for working capital, indicating that asset creation, while less common, yields disproportionately large returns.

Both schemes demonstrate strong inclusivity metrics. Under PMMY, women entrepreneurs accessed 69 per cent of all microloans, amounting to ₹13.8 lakh crore across 34.8 crore accounts. Reach among historically underserved groups is substantial: ₹3.60 lakh crore across 9 crore accounts of SCs, ₹1.33 lakh crore across 3.07 crore accounts of STs, ₹7.4 lakh crore across 15.34 crore accounts of OBCs, and ₹3.31 lakh crore across 5.98 crore accounts of minorities. For PM SVANidhi, one-third of the beneficiaries are women, 45 per cent belong to the OBCs, 17 per cent to SCs, and 2 per cent to STs.

The welfare effects of PM SVANidhi extend beyond enterprise metrics. Improved incomes have led to housing upgrades for 39 per cent of households, better food access for 55 per cent, more affordable healthcare for 44 per cent, and enhanced educational opportunities for 50 per cent. These multidimensional gains demonstrate how access to credit can foster broader household resilience. The scheme has also accelerated digital adoption, with usage

of digital payments rising from 45 per cent in 2023 to 83 per cent in 2025. Formal credit access has expanded correspondingly; 30 per cent of borrowers now hold formal loans in addition to their SVANidhi borrowings, compared to just 9 per cent prior to the scheme.⁵¹

Notably, both schemes demonstrate strong repayment performance, validating the creditworthiness of segments that have been traditionally deemed unbankable. Under the PM SVANidhi scheme, the estimated NPA rate is below 10 per cent, comparing favourably with the broader microfinance sector. The primary reasons for missed instalments are income disruption and health shocks, suggesting that complementary measures, such as affordable health insurance, could further strengthen repayment. Similarly, the NPA ratio for PMMY (as a percentage of the total loan disbursed) stood at 3.31 per cent as of June 2025.⁵²

The evidence from both schemes substantiates a virtuous cycle central to financial inclusion: credit access, repayment discipline, enterprise growth, and rising credit demand reinforce one another, progressively integrating borrowers into the formal financial system while strengthening their economic standing. Under the PM SVANidhi scheme, 66 per cent of borrowers expressed the need for additional loans, with average requirements rising from ₹38,000 in the first cycle to ₹86,500 in the third. This demand-side pull, combined with demonstrated repayment capacity, creates the foundation for sustainable credit deepening. Banks should take note. There is money on the table, and it is a rational economic response to take it.

Together, PMMY and PM SVANidhi demonstrate that well-designed micro-credit interventions can effectively integrate underserved populations into the formal financial system, generate measurable improvements in livelihoods, and establish the credit behaviours that underpin sustained access to finance.

3.50 Regulatory innovation is deepening financial inclusion in India. The account aggregator framework, a key DPI pillar, supplies lenders with verified data like bank transactions and GST records, enabling lending to underserved and first-time credit users. DPI payment interfaces, such as UPI, provide transaction data to assess creditworthiness. Box III.5 explores how UPI has driven financial inclusion and become a flagship success story.

Box III.5: Can payment infrastructure improve overall financial deepening?

While the expansion of bank accounts is a necessary foundation, it is the effective use of those accounts that ultimately determines whether financial inclusion translates into meaningful economic opportunity. A growing body of research shows that a public, interoperable payment infrastructure can play a catalytic role in this transition by converting basic access into active financial participation.

⁵¹ Centre for Analytical Finance, Indian School of Business. (2025). PM SVANidhi impact assessment report – 2025. (In collaboration with the Ministry of Housing and Urban Affairs, Government of India).

⁵² Lok Sabha Unstarred Question No. 2323 answered on 15 December 2025, <https://tinyurl.com/3755k6kj>

In particular, Shashwat Alok et al. (2024)⁵³ demonstrate how a digital payment layer such as UPI bridges the gap between account ownership and access to formal credit by generating verifiable transaction histories and sharply reducing transaction costs. Their study shows that digital public infrastructure reshapes credit markets by enabling banks and fintechs to expand lending across the risk spectrum, with fintechs playing a distinctive role in reaching new-to-credit borrowers who were previously excluded from formal finance. Regions with affordable internet and widespread bank account penetration experienced the strongest credit expansion, underscoring the layered nature of financial inclusion and the complementary roles of incumbents and new entrants.

Importantly, the growth in credit linked to digital payments did not come at the cost of higher default rates. On the contrary, richer transaction data allowed lenders to better identify underserved but creditworthy borrowers, enabling system-wide financial deepening without a deterioration in portfolio quality. This evidence highlights the power of publicly provided, interoperable infrastructure to support inclusion at scale and to align technological change with macro-level financial development.

Survey evidence reinforces these aggregate findings. Dubey and Purnanandam (2024)⁵⁴ show that UPI adoption is associated with higher economic output, while Artha Global's 2025 survey of 4,800 respondents across Maharashtra and Bihar provides a granular view of how digital payments are embedded in everyday economic life. Among users, UPI has become a general-purpose payment instrument, with at least 60 per cent using it across major transaction categories such as store purchases, peer-to-peer transfers, bill payments, and online commerce. Nearly 80 per cent reported using UPI for three or more distinct use cases, with broadly similar patterns across gender and rural-urban locations. This diversification suggests that once adopted, UPI quickly becomes an integral part of routine economic activity.

At the same time, digital payments are best understood as complementing, rather than abruptly displacing, cash. Over 90 per cent of UPI users continue to use cash regularly, reflecting a hybrid payments ecosystem that mirrors international experience. Rather than a simple transition to cashlessness, the evidence points to a gradual, layered evolution in which real-time payments expand choice, convenience, and efficiency while coexisting with established modes of exchange.

Despite UPI's remarkable reach, some access frictions remain, largely reflecting broader digital divides rather than resistance to the system itself. Therefore, the next phase of inclusion involves deepening digital capabilities, awareness, and confidence so that the benefits of UPI are more evenly distributed.

Looking ahead, the long-term sustainability of UPI will depend on aligning incentives across the ecosystem to support continued investment in infrastructure, reliability, and risk management, while preserving the openness and interoperability that underpin its success.

53 Alok, Shashwat et. al., Breaking Barriers to Financial Access: Cross-Platform Digital Payments and Credit Markets (2025). Working Paper 33259, <https://tinyurl.com/4cpue8kv>.

54 Dubey, T. S. and A. Purnanandam (2024, May). Can Cashless Payments Spur Economic Growth? University of Michigan Working Paper, <https://tinyurl.com/43ntsfeK>.

The zero-cost, public-good design has been central to rapid adoption, particularly among small merchants, and has enabled digital payments to become a default option for everyday transactions.

Overall, the evidence points to UPI as a cornerstone of India's financial deepening. Its significance lies not only in scale, but in how it has integrated digital payments into routine economic life, strengthened the link between access and credit, and created a platform for inclusive growth. The next set of priorities are less about whether the model works, and more about how to consolidate and extend its gains through complementary investments in digital capability and institutional capacity as the system continues to evolve and expand to include more users.

3.51 All the above efforts are reflected in the RBI's Financial Inclusion (FI) Index,⁵⁵ which measures the country's progress in achieving financial inclusion. It captures data on 97 indicators related to banking, investments, insurance, postal, and pension sectors across three dimensions: access, usage, and quality. These dimensions are represented through three sub-indices, viz., FI-access, FI-usage, and FI-quality.⁵⁶ The composite FI-Index value rose to 67.0 in March 2025 from 64.2 in March 2024, with all sub-indices registering steady growth.

Performance of the Insolvency and Bankruptcy Code

3.52 While financial intermediaries fulfil their role in extending credit to diverse economic agents, debtors may occasionally encounter difficulties in their endeavours. This necessitates the implementation of mechanisms to rehabilitate their financial standing or facilitate an honourable exit. It is towards this end that the IBC established a unified framework for resolving corporate distress in India, replacing the earlier fragmented regime of multiple statutes with overlapping jurisdictions. The Code enables financially distressed businesses to be reorganised through a creditor-driven resolution process within defined timelines or liquidated when continuation is not viable. Over nine years, IBC has contributed to improved credit discipline, a reduction in banking sector NPAs, and greater predictability in insolvency outcomes.

3.53 Reflecting these systemic improvements, S&P Global Ratings upgraded India's

⁵⁵ 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 index captures information on various aspects of financial inclusion in a single value ranging between 0 and 100, where 0 represents complete financial exclusion, and 100 indicates full financial inclusion. The FI-Index comprises three broad parameters (weights indicated in brackets), namely Access (35%), Usage (45%), and Quality (20%), each consisting of various dimensions that are computed based on a number of indicators.

⁵⁶ The 'Access' sub-index covers the availability of the supply side of financial inclusion through physical and digital infrastructure. The 'Usage' sub-index reflects the demand for financial inclusion as is reflected by the total number of credit accounts, volume and value of UPI transactions etc. Finally, the 'Quality' sub-index reflects aspects such as financial literacy, consumer protection and inequality.

insolvency regime from 'Group C' to 'Group B' on 3 December 2025.⁵⁷ The rating agency noted that average recovery rates have improved from 15-20 per cent under the pre-IBC regime to approximately 30 per cent, while resolution timelines have reduced from 6-8 years to about 2 years. Secured creditors, in particular, have experienced significantly higher recoveries. The Report has also acknowledged the role of judicial reinforcement of creditor rights, which have contributed to greater predictability and discipline in the resolution process.

3.54 Out of the corporate insolvency resolution process (CIRP) proceedings closed as of September 2025, 57 per cent resulted in going-concern rescue (1,300 through resolution plans, 1,342 through appeal/review/settlement, and 1,223 withdrawn under Section 12A), while 43 per cent ended in liquidation orders affecting 2,896 firms. Over time, the resolution-to-liquidation ratio has improved from 20 per cent in FY18 to 91 per cent in FY25.⁵⁸

3.55 From the 1300 cases that resulted in a resolution process, creditors realised ₹3.99 lakh crore. Creditors recovered 94 per cent of the fair value of resolved businesses,⁵⁹ and 170 per cent of what they would have received through liquidation. While the haircut relative to fair value was approximately 6 per cent, it was 67 per cent relative to admitted claims. The data indicate that resolution, where feasible, delivers significantly better outcomes for creditors than liquidation.

3.56 A comprehensive study by IIM Bangalore documents a measurable improvement in credit discipline since IBC's enactment.⁶⁰ The study utilises nearly 6 crore corporate loan filings made between 2018 to 2024. As the study finds, the proportion of overdue corporate loan amounts relative to total outstanding fell from 18 per cent in 2018 to 9 per cent in 2024. Further there is a decrease in the average number of days for accounts to transition from overdue to normal category and from default to normal category during the period 2019 to 2024 (Chart III.12).

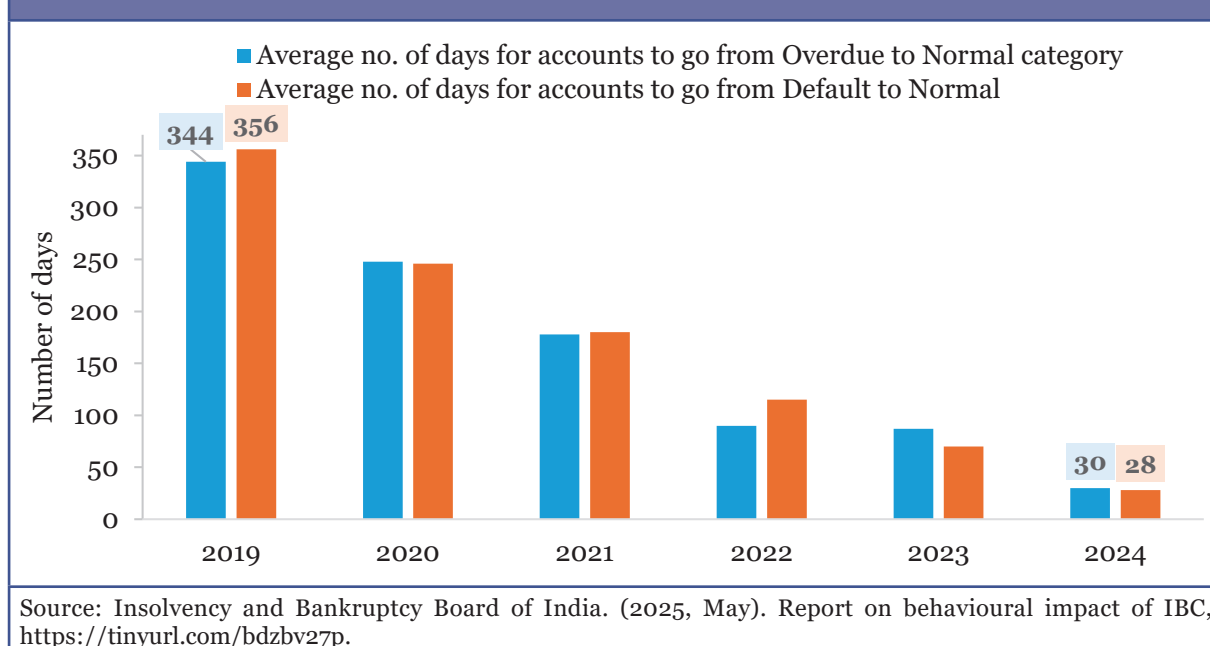
57 Rankings are grouped into Group A (most efficient), Group B (moderately effective), and Group C (least effective).

58 Insolvency and Bankruptcy Board of India. (2025, June 30). Quarterly newsletter for April–June 2025, <https://tinyurl.com/3bsvrfff>.

59 Based on 1177 cases where fair value has been estimated.

60 Insolvency and Bankruptcy Board of India. (2025, May). Report on behavioural impact of IBC, <https://tinyurl.com/bdzbv27p>.

Chart III.12: Trend of Transition Time- Overdue Accounts



3.57 The study observed that financially distressed firms (defined as those with an interest coverage ratio below 1 and leverage in the highest quartile) experienced a 3 per cent reduction in the cost of debt relative to non-distressed firms following IBC implementation, suggesting improved credit access for viable but stressed enterprises. Further, corporate governance indicators also improved. The proportion of independent directors on company boards increased by 2.84 per cent after the implementation of the IBC, with distressed firms showing an increase of 2.52 per cent.

3.58 A subsection of the study examines 51 banks between 2010 and 2024. Controlling for bank-specific characteristics, the study observes that IBC implementation is associated with a reduction in the Net NPA to Net Advances ratio of approximately 0.96 per cent.

3.59 Notwithstanding the structural shifts brought about by IBC, the bankruptcy regime still offers scope for significant improvement. Primary among the issues is the presence of a binding institutional constraint, leading to insolvency proceedings that often stretch beyond their mandated timelines. The Code mandates CIRP completion within 330 days, including extensions; actual average duration is 713 days overall and 853 days for cases closed in FY25. This represents a deviation of over 150 per cent from the statutory limit.⁶¹

⁶¹ The contents of this section use data from the Standing Committee on Finance. (2025, December). Review of working of Insolvency and Bankruptcy Code and emerging issues (Twenty-eighth report). Lok Sabha Secretariat, <https://tinyurl.com/mr45a84x>.

3.60 Compounding the insolvency timelines, the National Company Law Tribunal (NCLT) holds a pendency of nearly 30,600 cases (as of March 2025) with an estimated clearance time of nearly 10 years at current disposal rates. Such extended timelines can trigger value erosion - assets deteriorate, employees depart, customers shift to competitors, and supplier relationships break down.

3.61 The institutional constraint is present at the level of the courts as well as at the level of the Resolution Professionals (RPs).⁶² Only 30 NCLT benches handle cases across IBC and Companies Act jurisdictions, and RPs are also in short number. Of 4,527 registered RPs, only 2,198 (49 per cent) hold active Authorisation for Assignment.

3.62 In light of the extended insolvency timelines, the Pre-Packaged Insolvency Resolution Process (PPIRP) was introduced in 2021 to provide a simpler, faster, and less costly resolution. However, PPIRP has seen only 14 admissions in four years. The reasons behind the low take-up include procedural complexity that is inappropriate for the target segment, a lack of awareness among MSME promoters and lenders, trust deficits regarding debtor-led processes, and the inability of small enterprises to fund the process.

3.63 Recognising these challenges, the IBC Amendment Bill 2025⁶³ proposes a range of measures aimed at addressing procedural delays within the system. It also proposes a framework for cross-border insolvency proceedings. While the previous decade offered testament to IBC's legal framework and design, the next phase of IBC should combine process reform with a rapid scaling of capacity.

Development in the capital markets

3.64 Capital markets help finance economic growth by channelising savings to investments. They are catalysts for wealth creation in the economy. The year FY26, so far, has been eventful for the economies and markets worldwide, including those in India. In the midst of continuous shifts in trade policies and exacerbated uncertainties, India's equity markets exhibited a phase of measured yet resilient performance, reflecting the interplay of supportive policies, macroeconomic conditions and sustained domestic investor participation. The imposition of US tariff sanctions, weaker-than-expected corporate earnings in Q1 FY26 and foreign capital outflows collectively weighed on market sentiment. However, a series of measures, including a personal income tax cut, a GST overhaul, easing of monetary policy, and receding inflation, as well as improved corporate performance in Q2 FY26, supported the market during the period.

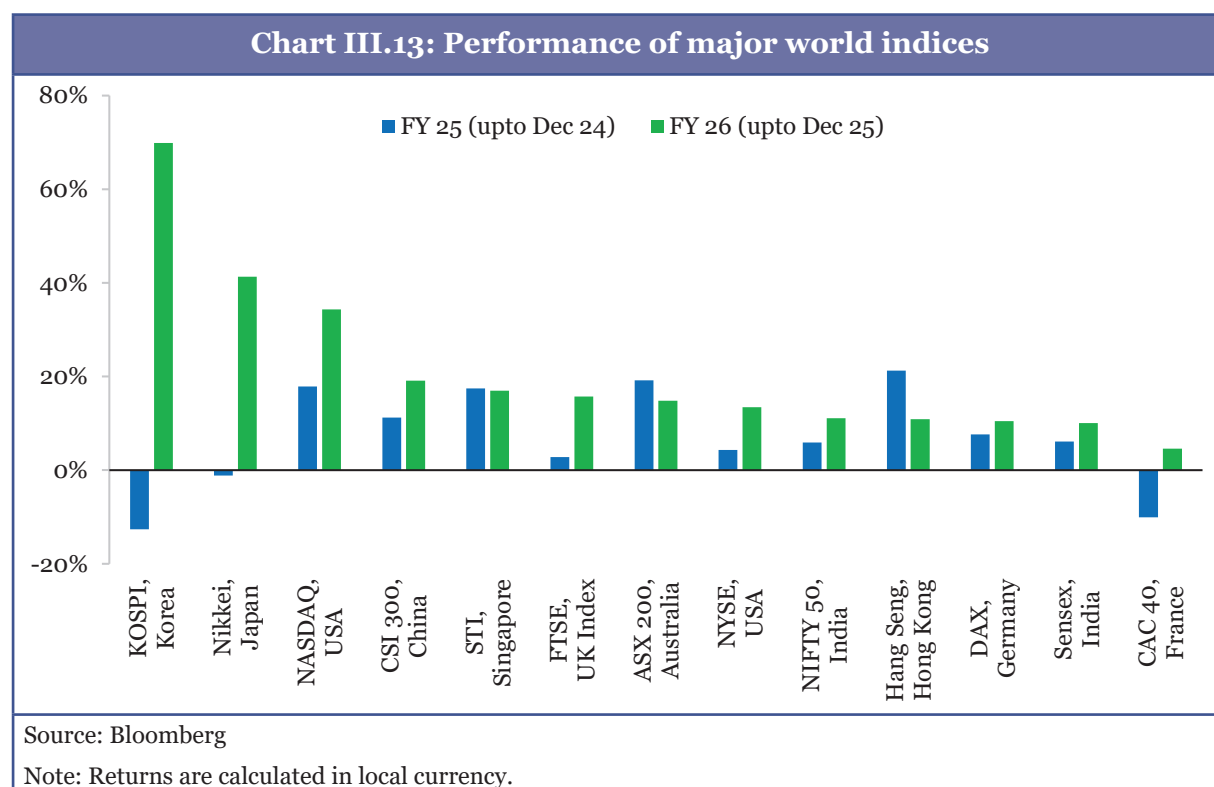
⁶² Resolution professionals are certified individuals tasked with managing the insolvency process.

⁶³ The bill was introduced in the Lok Sabha in August 2025 and referred to a Select Committee. The Committee has since submitted its report in December 2025.

3.65 Nifty 50 and BSE Sensex registered gains of approximately 11.1 per cent and 10.1 per cent, respectively, during April-December 2025, marking a period of correction and consolidation following the robust rally observed in the preceding fiscal year.

3.66 In comparative terms, India's equity market performance was subdued relative to its global peers such as South Korea (KOSPI), the US's NASDAQ, Japan's Nikkei, China's CSI 300 and Singapore's STI. In India, sectoral trends reflected the broader macroeconomic narrative. Financial, capital goods, and consumer-oriented sectors outperformed, supported by healthy credit growth and domestic consumption, while IT and export-driven segments lagged amid muted external demand.

3.67 Reflecting the strength of India's financial ecosystem, the primary markets in FY26 (up to December 2025) remained resilient and vibrant, leading the world in initial public offers (IPOs) issuances. This strong performance was underpinned by sound macroeconomic fundamentals, robust investor participation and the continued fine-tuning of regulatory frameworks by SEBI, despite global headwinds. India's primary markets continued to attract both domestic and international investors, reinforcing the country's position as a key driver of global capital formation.



3.68 The total resource mobilisation from primary markets, encompassing both debt and equity, stands at ₹10.7 lakh crore during FY26 (till December 2025). Over the past five years, from FY22 to FY26 (till December 2025), India's primary markets have been

instrumental in channelising savings into productive investments, mobilising a total of ₹53 lakh crore through equity and debt issuances. Of this, ₹14 lakh crore was raised through equity issuances.

3.69 IPO volumes in FY26 (up to December 2025) were 20 per cent higher than FY25, and the amount mobilised was 10 per cent higher than the corresponding period of FY25. Listings on the main board, the primary market for established companies meeting stricter regulatory and size thresholds, rose from 69 to 94, with the amount raised increasing from ₹1,46,534 crore to ₹1,60,273 crore. A notable feature of IPO activity in FY26 (up to December 2025) was the prominence of Offer for Sale (OFS) components, where existing shareholders sell their stakes rather than the company issuing new shares. OFS accounted for 58 per cent of the total proceeds.

3.70 The activity in the small and medium (SME) segment also continued to exhibit a buoyant trend during FY26, reflecting sustained investor interest and growing confidence in emerging enterprises. The number of SME listings in FY 26 (up to December 2025) increased to 217 from 190 in FY25 (up to December 2024). The amount mobilised increased from ₹7,453 crore to ₹9,635 crore. Since its inception, more than 1,380 companies have been listed on the SME platforms of BSE and NSE, cumulatively raising over ₹35,000 crore, highlighting the expanding footprint of India's entrepreneurial base within the formal capital market framework. Of these, around 350 companies have migrated to the mainboard platform, underscoring the role of SME exchanges as a stepping stone for high-potential firms.

3.71 The sustained mobilisation of resources through primary markets and the widening participation of emerging enterprises through SME platforms point to the increasing breadth and sophistication of India's capital markets. As market activity scales up and new intermediaries and instruments proliferate, the quality of regulatory governance becomes central to preserving market integrity. In this context, the Securities Markets Code, 2025, represents an important step towards consolidating the legal framework and strengthening the foundations of securities market regulation.

Box III.6: Reinventing Market Regulation: Securities Markets Code, 2025

The Securities Markets Code, 2025 (SMC), was introduced in Lok Sabha on 18 December 2025, fulfilling a commitment announced in the Union Budget 2021-22.⁶⁴ It repeals and replaces the Securities Contracts (Regulation) Act, 1956, the SEBI Act, 1992, and the Depositories Act, 1996, thereby consolidating the fragmented laws governing India's securities markets. The Code spans subjects such as board composition, independence, conflict management, transparency, regulatory sandboxing, investor protection, governance of market

⁶⁴ The Bill has since been referred to a Standing Committee for examination.

infrastructure institutions (MIIs), and ease of doing business. These reforms can be categorised into three main clusters.

(1) Mechanisms for the delivery of services

SEBI has quasi-legislative, executive, and quasi-judicial powers. The SMC makes various provisions on the manner in which these services are delivered.

Rule-Making: Given SEBI's wide-ranging quasi-legislative, executive, and quasi-judicial powers, the SMC seeks to make rulemaking transparent, consultative, and accountable. Regulations must undergo public consultation through the publication of drafts, solicitation of comments, and disclosure of feedback. The Governing Board, which must include up to six independent members, can alone frame regulations, ensuring that diverse, non-executive perspectives shape policy. Reviews of regulations are mandatory, except in cases of urgency.

The governance framework also extends to MIIs' bylaws, which must align with the Code's objectives, guarantee equal access, prevent market abuse, and promote transparency and interoperability. These, too, require public consultation and approval from SEBI. Even government-made rules must undergo prior publication.

Adjudication: Historically, SEBI's interim orders lingered for years, effectively penalising individuals longer than warranted. The SMC caps the validity of interim orders at 180 days, extendable only by reasoned decisions of designated board members, with a maximum limit of two years. Interim measures remain temporary, preventing misuse of prolonged enforcement.

Executive Action: The SMC establishes a unified registration and licensing framework that covers application, scrutiny, and surrender, embedding due process at every stage. Investigations and inspections need written orders, specified time limits, and extensions based on recorded reasons. Enforcers must quantify unlawful gains or investor losses to ensure accountability. No inspection or investigation may begin more than eight years after a contravention, reinforcing fairness and predictability.

(2) Regulatory Governance

The Code places regulatory governance at the centre across three key pillars:

Board Composition: The SEBI board currently comprises nine members; however, under the SMC, the number of members appointed by the central government increases to 15, with at least five full-time members. The broader composition ensures diversity of expertise across law, economics, and market operations, with at least three members required to have experience in securities markets. This blend of professionals is intended to strengthen deliberations and internal accountability.

Independence: The Code safeguards SEBI's autonomy over rulemaking, inspections, and enforcement, free from executive interference. It preserves financial and staffing independence and codifies institutional safeguards - eligibility standards, fixed tenures, removal protections, and post-employment cooling periods that bar immediate work with

government, intermediaries, or market participants. Such measures preserve both functional and perceived independence.

Accountability: Transparency is reinforced through a publicly accessible electronic database of regulations, orders, and instructions. SEBI must make its regulations governing meetings of the Governing Board public and disclose the decisions of its board. The Code also requires regular research, impact assessments, and performance audits of both the regulator and the market ecosystem, with mandatory publication of results. SEBI is required to periodically review the proportionality and effectiveness of its regulations, preferably through independent external evaluations - a standard SEBI already applies to MIIs.

(3) Market Infrastructure Institutions

For the first time, the Code brings MIIs, stock exchanges, clearing corporations, depositories, and others, onto a clear statutory footing, formally recognising them as entities performing vital public functions. Previously treated as regulated market utilities, MIIs are now positioned as statutory organs of governance with clearly assigned responsibilities. The Code permits SEBI to delegate regulatory powers, such as intermediary registration, to MIIs, provided they uphold procedural fairness, natural justice, and confidentiality. Decisions must be reasoned, and affected parties retain a right to be heard. MIIs may also regulate certain classes of market participants, elevating their role from operational to quasi-regulatory. Under the SMC, MIIs must be registered, not merely recognised, giving them statutory existence subject to ongoing supervisory and governance standards. Registration confers legal status and establishes accountability mechanisms, including the possibility of supersession in cases where governance fails.

Conclusion

The SMC's framework extends beyond the securities market, serving as a potential model for regulatory governance across India's wider financial and administrative sectors. Its principles—transparency, consultation, proportionality, and accountability—could guide the creation of other regulators or the reform of existing ones.

By codifying SEBI's pioneering regulatory model, the SMC cements India's leadership in designing modern financial oversight architecture. If implemented in both letter and spirit, it could restore and strengthen trust among regulators, market participants, and investors. The ultimate test will be how deeply these governance standards embed themselves into everyday regulatory practice and whether they inspire similar transformation across India's regulatory landscape.

Broadening retail participation in capital markets

3.72 Since the pandemic, domestic retail participation has witnessed an unprecedented surge, both direct (trading in markets through their demat accounts) and indirect channels (through mutual funds). Stable macroeconomic fundamentals, corporate earnings prospects, technological innovations enabling seamless investor onboarding

through simplified KYC processes and strong regulatory oversight have collectively contributed to this expansion, thereby financializing savings from traditional channels to formal financial assets. Findings from SEBI's Investor Survey 2025 further underscores this transformation, as nearly 63 per cent of the households surveyed are aware of at least one securities market product.⁶⁵

3.73 During FY26 (till December 2025), 235 lakh of demat accounts were added, pushing the total count beyond 21.6 crore. A key milestone was the crossing of the 12-crore mark for unique investors in September 2025, with nearly a fourth of them being women. The mutual fund industry also expanded, with 5.9 crore unique investors as at the end of December 2025, of which 3.5 crore (as of November 2025) were from non-tier-I and tier-II cities, underscoring the diffusion of financial participation beyond traditional urban centres. Box III.7 examines the evolution of household financial savings over time in the country.

Box III.7: Evolving patterns of household financial savings in India

The composition of household financial savings in India has undergone a significant shift over the past decade, indicating a deeper reconfiguration in how households allocate incremental financial resources. This transition has been marked by a gradual but persistent movement towards market-linked instruments, particularly equities, reflecting both structural changes in the financial system and evolving household risk preferences. Equity investments, which were once ancillary to household balance sheets, have increasingly become a significant component of financial wealth, supported by broader participation and more diversified channels of access. Beyond equities, the development of debt-linked instrument markets is a logical next step towards achieving balanced, diversified portfolios and meeting long-term financial goals.

A salient feature of the shift to equities is the increasing share of individuals in aggregate equity market ownership, achieved through both direct and indirect channels. The share of individual investors increased from ~11 per cent in FY14 to 14.3 per cent in FY19, and further to 18.8 per cent by September 2025. In absolute terms, individual equity holdings expanded to around ₹84 lakh crore by September 2025, from just 8 lakh crore in FY14. While the direct share of individuals in equity markets increased only gradually, from just under 8 per cent in FY14 to approximately 9.6 per cent by September 2025, the indirect share nearly tripled over the same period, reaching 9.2 per cent. Between April 2020 to September 2025, household equity wealth is estimated to have increased by about ₹53 lakh crore, underscoring the role of sustained participation in driving long-term wealth creation in equity markets.

The evolving equity orientation is also evident in the flow of household financial savings. Between FY12 and FY25, gross financial savings increased substantially, accompanied by a notable reallocation across instruments. The share of equity and mutual funds in annual

⁶⁵ SEBI's Investor Survey 2025, <https://tinyurl.com/mrw33mrn>.

household financial savings increased from ~2 per cent in FY12 to over 15.2 per cent in FY25. This shift has coincided with a steady rise in SIP contributions, with average monthly SIP flows increasing seven times from under ₹4,000 crore in FY17 to over Rs 28,000 crore in FY26 (April-November).

The growing prevalence of systematic investments reflects a shift towards long-term and sustained household engagement with savings being channelled in a disciplined manner across market cycles. In contrast, the share of deposits declined from over 58 per cent in FY12 to around 35 per cent in FY25, after having fallen to as low as 31.9 per cent in FY22. This pattern suggests portfolio diversification rather than displacement, with households adding equity exposure to their existing savings rather than substituting entirely away from traditional instruments.

From a stock perspective, the rebalancing is equally evident in household balance sheets. According to RBI data, the share of equity and investment funds in total household financial assets increased from 15.7 per cent in March 2019 to 23 per cent by March 2025. Assets managed through mutual funds rose steadily relative to the size of the economy, increasing from <10 per cent of GDP in the early 2010s to ~23 per cent by FY26 (as of November 2025), amounting to over ₹80 lakh crore.

Chart III.14: Ownership trends of individual investors

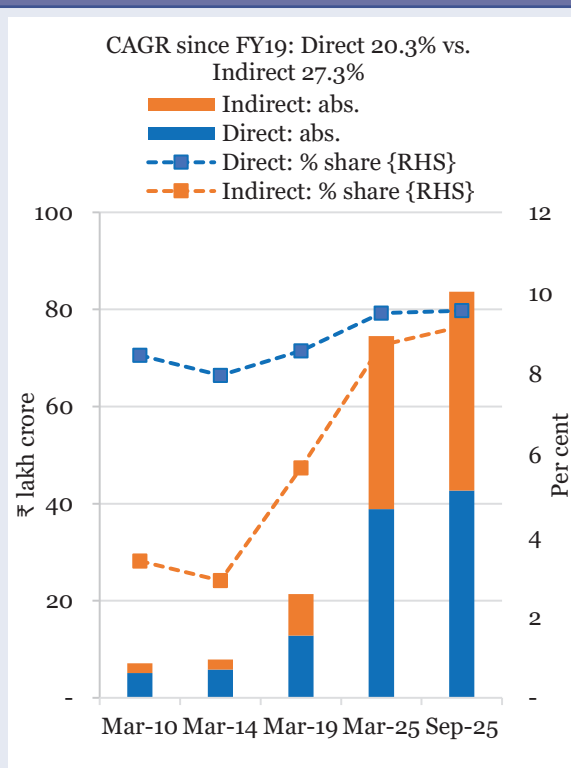
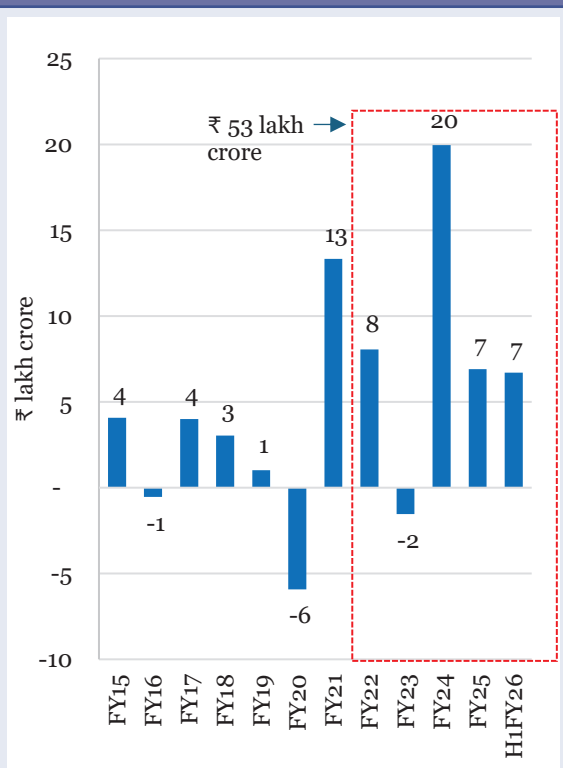
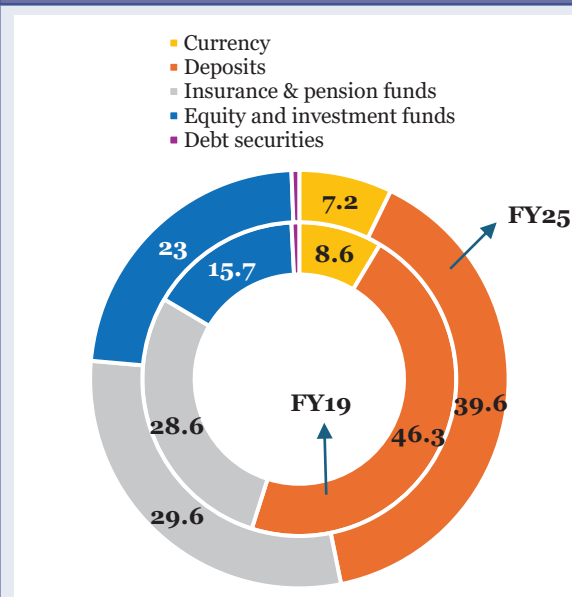
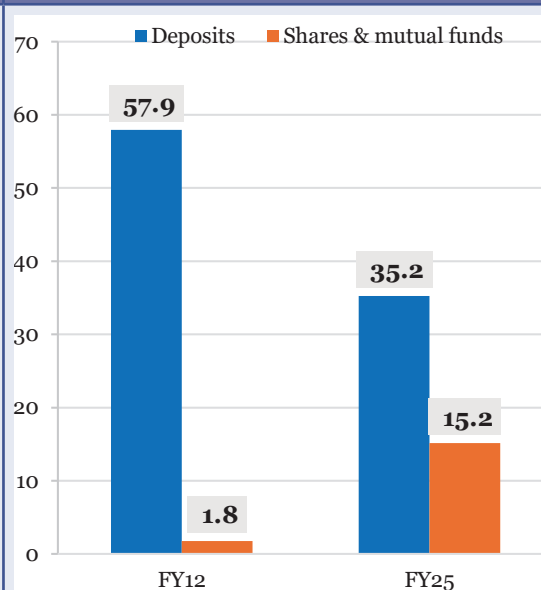


Chart III.15: Household wealth accretion in Indian equities*



Source: NSE EPR. Notes: 1) Direct is defined as the direct equity holdings, while indirect is the equity holdings through mutual funds by individuals. 2)* NSE-listed companies considered for the analysis.

Chart III.16: Composition of financial assets in FY19 vs FY25

Chart III.17: Composition of annual financial savings for select products (% share)


Source: NSE EPR. Notes: 1) Direct is defined as the direct equity holdings, while indirect is the equity holdings through mutual funds by individuals. 2)* NSE-listed companies considered for the analysis.

The post-pandemic period marked a decisive inflexion in household engagement with equity markets. The unique investor base expanded sharply in the initial years following the pandemic, rising from around 3.1 crore in FY20 to over 11 crore by FY25. Although net additions to the investor base have moderated in the current fiscal, net inflows of domestic investors into equity markets have remained resilient. Over the past five years, cumulative inflows by domestic investors into the equity markets have been substantially higher than from foreign investors. This shift highlights the increasing ability of domestic savings to support equity markets, stabilise the market, and mitigate the volatility associated with external capital flows.

A well-diversified portfolio should include adequate exposure across a broad range of asset classes. In this context, participation in debt, specifically market-based debt instruments, has not kept pace with the significant reorientation of household savings towards equities. The household ownership share of deposits has decreased, while that of pension and insurance assets has remained almost unchanged over the period from FY19 to FY24.

Retail engagement with corporate bonds and debt-oriented investment products remains limited, resulting in debt securities comprising a small portion of household financial assets. This limited participation of households in market-based debt instruments is mirrored in the overall shallow depth of India's corporate bond market. India's corporate bond market remains underdeveloped, accounting for around 16-17 per cent of GDP, compared with the equity market capitalisation of over 130 per cent of GDP. This is substantially lower than in major peer economies, such as the United States and China, where corporate bond markets constitute approximately 40 per cent and 36 per cent of GDP, as of 2024, respectively.

Developing a deep debt capital market requires market participants—issuers, investors, arrangers, and rating agencies—to act as market-builders. Key imperatives include enhancing transparency, pricing risk honestly beyond the siloes of AAA-rated bonds, and ensuring financial innovation remains standardised. Mechanisms such as partial guarantees and blended finance can help mid-tier companies access bond markets, unlocking capital for this segment and driving India's future growth. Equally, a shift from passive buy-and-hold strategies to active trading is essential for building secondary market liquidity. A well-functioning debt market would reduce capital costs, mobilise savings efficiently, and offer households reliable income-generating products. India's households have embraced equities; extending that confidence to debt markets is the next frontier for building truly resilient portfolios and a mature financial system.

3.74 Responding to the steady expansion of India's capital market, SEBI has undertaken various steps throughout the current financial year in order to strengthen the regulatory framework, facilitate ease of doing business and investing, enhance investor protection and empowerment, and foster market development. These measures have been discussed in detail in Box III.8.

Box III.8: SEBI's recent initiatives: Advancing regulatory excellence, market growth, and investor protection

SEBI undertook a comprehensive suite of initiatives aimed at reinforcing regulatory integrity, streamlining market operations, and enhancing investor protection. Collectively, these measures underscore SEBI's commitment to fostering a transparent, resilient, and inclusive capital market ecosystem in India, while strengthening market confidence through improved verification, disclosure, accessibility, and risk surveillance across key segments of the securities market.

Investor protection and empowerment

To provide a verified and secure payment channel for financial transactions in the securities market, SEBI has mandated a new UPI address structure for all SEBI-registered intermediaries that collect funds from investors, effective 1 October 2025. Complementing this, the 'SEBI Check' was introduced to enable verification and enhance the safety and accessibility of investor payments. To combat financial fraud and scams, SEBI launched a joint media campaign titled 'SEBI vs SCAM' in collaboration with Market Infrastructure Institutions in July 2025, focusing on identifying red flags, raising awareness about verification protocols, trusted redressal mechanisms, and good digital practices. In parallel, a nationwide training initiative for block-level Panchayat representatives was launched in collaboration with the Ministry of Panchayati Raj (MoPR) to promote financial literacy and investor education at the grassroots level. Furthermore, SEBI mandated that all digital platforms of regulated entities comply with the provisions of the Rights of Persons with Disabilities Act, 2016, and corresponding rules, enabling the full and effective participation of persons with disabilities in the securities market.

Strengthening the bond market and expanding access

SEBI introduced a new framework for ESG Debt Securities (other than green debt securities), outlining regulatory requirements for issuers of social, sustainability, and sustainability-linked bonds. To improve awareness and traction in municipal debt, outreach programmes on Municipal Bonds and Municipal Finance were organised, providing a common platform for stakeholders to discuss issuer concerns, investor requirements, and the extant regulatory framework, while also recommending measures to deepen the market. In support of municipal bond development, credit rating agencies were advised to extend the EL-based rating scale for rating municipal bonds issued to finance infrastructure assets, in addition to the standardised rating scale. Additionally, to facilitate ease of doing business and improve transparency and data dissemination to investors and credit rating agencies for the issuance of securitised debt instruments (SDI), SEBI aligned the guidelines for the issue and listing of SDIs with the RBI guidelines on Securitisation of Standard Assets.

Strengthening the regulatory framework and improving operational efficiency

To facilitate SEBI-registered stock brokers in undertaking securities market-related activities in GIFT-IFSC under a Separate Business Unit, the requirement of obtaining specific SEBI approval was removed. Listed entities were mandated to follow industry standards on the ‘minimum information’ to be provided to the audit committee and shareholders for the approval of related-party transactions, thereby strengthening governance and review processes. SEBI also streamlined requirements pertaining to the minimum contribution from sponsors and sponsor groups in the public issue of units for the conversion of a private listed Infrastructure Investment Trust (InvIT) into a public InvIT. Further, registered intermediaries were permitted to use the ‘e-KYC Setu System’ of the National Payments Corporation of India as an alternative to Aadhaar-based e-KYC authentication.

Fostering market development and improving product depth

To provide investors with independent verification of the risk and return claims of investment advisers, research analysts, and algorithmic trading providers, SEBI introduced a Past Risk and Return Verification Agency for risk-return performance verification; its operationalisation is in process. In the derivatives space, electricity derivatives, starting with monthly futures trading at NSE, were launched on 18 July 2025. SEBI and the Central Electricity Regulatory Commission adopted a robust, consultative, and data-driven approach to contract design and risk management norms, ensuring these derivatives function as hedging instruments rather than vehicles for undue speculation.

Measures to strengthen equity derivatives markets

To curb expiry-day volatility and promote uniformity, exchanges were directed to select either Tuesday or Thursday as the expiry day for equity derivatives. SEBI also introduced revisions to improve trading convenience and strengthen monitoring, including a new methodology for calculating open interest as future equivalent open interest at a portfolio level using delta adjustments, recalibrating the market-wide position limit for single stocks, defining new eligibility criteria for derivatives on non-benchmark indices, and recalibrating

entity-level position limits based on the revised market-wide position limit definition. In addition to end-of-day monitoring, exchanges were directed to monitor position limits for equity index derivative contracts on an intraday basis.

Debt market

3.75 A well-developed corporate bond market is indispensable to India's financial system and its path toward becoming a Viksit Bharat by 2047. Such a market channels institutional and household savings into productive sectors, strengthens efficient price discovery through a robust yield curve and supports the development of critical risk management instruments such as credit derivatives and securitisation. For the financial sector specifically, a deep corporate bond market reduces systemic concentration risk and dependence on bank-dominated financing, thereby strengthening overall financial stability. By diversifying funding sources, the corporate bond market enables banks to redirect resources toward priority sectors, including rural credit, infrastructure, and MSMEs, advancing financial inclusion while lowering systemic fragility. Additionally, a vibrant bond market helps to lower borrowing costs through competitive pricing and improved liquidity.

3.76 India's corporate bond market has demonstrated impressive growth, with outstanding issuances increasing from ₹17.5 trillion in FY15 to ₹53.6 trillion in FY25, growing with an annual rate of approximately 12 per cent. In FY25, the highest-ever fresh issuances were recorded, totalling ₹9.9 trillion. As of March 2025, the corporate bond market accounts for 15-16 per cent of the country's GDP and corporate bond fundraising now complements bank credit, reflecting growing investor confidence and a gradual shift towards market-based financing.

3.77 In FY26, the debt market accounted for over 63 per cent of total resource mobilisation from the primary market in April-December 2025. Government and SEBI initiatives to deepen the bond market contributed to the value of corporate bond issuances reaching ₹6.8 lakh crore by the end of December 2025. Private placements, accounting for more than 99 per cent of total resources mobilised through the bond market, remained the preferred mode.

3.78 Despite the recent progress, a significant potential remains untapped in the country compared to global peers: South Korea's corporate bond market is 79 per cent of its GDP, in Malaysia, it is 54 per cent of its GDP, and in China, 38 per cent. Furthermore, India's debt market is skewed towards highly rated borrowers (AAA or AA-rated), which accounts for 85-90 per cent of bond issuances. In contrast, the US presents a more liquid and mature corporate debt market catering to various segments. The US has less than five per cent of its bond issuances from AAA-rated categories, with

over 60 per cent of its issuances in the A- and BBB-rated categories. In India, with the dominance of private placements, public offerings remain limited, deterring access for small firms. The secondary market remains shallow, with India's annual bond turnover ratio in secondary markets at 0.3, lower than that of Indonesia (1.17) and China (1.16).⁶⁶

3.79 The major issuers in the corporate debt market include Public Sector Undertakings, Public Financial Institutions, and banks. As of 31 December 2025, the market comprised 6,351 issuers with a total of 29,638 instruments outstanding. The principal investor base consists of banks, insurance companies, pension funds, mutual funds, and NBFCs. Out of approximately 30,000 ISINs,⁶⁷ only 400-500 ISINs are traded on a daily basis. New issuances are traded for a month or so, and then they are held until maturity, essentially becoming a type of investment. The daily average secondary market volume ranges from ₹7,000 crores to ₹10,000 crores. Only a small group of institutional investors participate in the primary markets, which limits the supply of bonds available for trading in the secondary market.

3.80 Institutional investors are shown to exhibit structural preferences influenced by return profiles, risk assessments, regulatory incentives, and prevailing market liquidity conditions. As a result, they tend to favour equities and government securities over corporate bonds. This trend may be contributing to the constraining of the corporate bond market's growth and development.⁶⁸

3.81 As noted by the Niti Aayog Report, limitations also stem from regulatory overlaps between SEBI, RBI, and the Ministry of Corporate Affairs (MCA); extensive disclosure requirements that deter lower-rated issuers; restricted investment mandates for institutional investors, limiting their allocation to high-grade securities; and an underdeveloped risk management infrastructure. Additionally, weak debt recovery mechanisms, high transaction costs, and tax asymmetries reduce investor appetite and limit the flow of long-term capital.

3.82 The regulatory authorities have undertaken substantial reforms for the development of the bond market. SEBI introduced the Request for Quote platform, facilitating retail access, strengthening governance standards for credit rating agencies, and simplifying issuance norms. The RBI has enhanced settlement architecture through tri-party repos and credit default swap guidelines. The Government's promotion of InvIT and Real Estate Investment Trusts demonstrates a sustained commitment to long-term capital mobilisation.

66 NITI Aayog. (2025, December). Deepening the corporate bond market in India (Report), <https://tinyurl.com/27dha24u>.

67 International Securities Identification Numbers

68 Gupta, S., Kujur, K., & Arora, O. (2025). Bridging the gap: Unlocking retail participation in India's bond market (SSRN Scholarly Paper No. 5332702). Social Science Research Network.

3.83 However, coordinated and phased reforms are the need of the hour. These include streamlining inter-agency alignment through joint circulars that clarify responsibilities across the regulators, as well as establishing single-window contact systems for issuers. Strengthening investor confidence in corporate debt also requires enhancing the effectiveness of the insolvency framework so as to accelerate recovery timelines. Long-term structural development should prioritise upgrading market infrastructure through unified trading platforms and enhanced market-making capabilities, while expanding the investor base through targeted incentives, including simplified tax structures for bonds and regulatory flexibility for pension funds and insurance companies to invest in mid-rated securities.

3.84 A vibrant corporate bond market can help lower the cost of capital for Indian firms through competitive pricing, improved liquidity, and efficient price discovery. As the market deepens, towards a potential ₹100-120 trillion by 2030,⁶⁹ intermediation costs should decline, particularly for the mid-market segment, where much of India's manufacturing capacity and job creation will emerge. Realising this vision demands sustained, coordinated policy focus, technological innovation, and regulatory harmonisation.

3.85 However, financial deepening alone may not be sufficient to durably lower India's cost of capital. Box III.9 explores the structural drivers of capital costs, highlighting that the path to cheaper capital extends not only through financial markets but also through productivity and export competitiveness - themes central to India's development trajectory.

Box III.9: What explains the persistently high cost of capital? - an exploration

India's relatively high cost of capital is widely recognised as a constraint on private investment and long-run growth. For instance, over the past three decades, between 1995 and 2025, India's weighted average long-term interest rates⁷⁰ averaged 7.61 per cent, far above the average long-term rates seen in Canada (3.13), Italy (2.94) and Switzerland (1.04). Even so, India has maintained a favourable average long-term interest rate as compared to other emerging economies such as Indonesia (14.1), Mexico (11.05) and South Africa (9.08).

Much of the public discussion attributes this to financial-sector frictions – relatively shallow corporate bond markets, limited institutional investor depth, sovereign risk premia, and

69 NITI Aayog. (2025, December). Deepening the corporate bond market in India (Report), <https://tinyurl.com/27dha24u>.

70 Weighted long term interest rates is measured as a weighted average of central bank policy rates and 10-year government bond yields, weighted by the share of bank and market-based credit in total credit to the private non-financial sector.

regulatory restrictions on capital flows. While these factors influence the distribution of financing costs across firms and sectors, they do not fully explain the persistence of high economy-wide capital costs.

A more structural explanation for the high cost of capital in an economy links the cost of capital to the economy's savings position and external balance. In open-economy macroeconomics, investment must be financed either by domestic savings or by foreign savings; the latter is reflected in the current account deficit (CAD). Economies that run persistent CADs are, by construction, dependent on external capital inflows to support domestic investment and consumption. This dependence introduces a risk premium, which financial markets price into interest rates and equity returns.⁷¹ In this sense, the cost of capital in CAD economies is not merely a financial-market outcome; it is also a price on the macroeconomic risk associated with a structural savings shortfall.

To empirically capture the structural relationship between the current account balance (CAB) and long-term interest rates, a panel data estimation is performed for 15 countries over the period from 1995 to 2025. The countries studied comprise a heterogeneous mix of developing and developed economies, which displayed floating or managed floating exchange rate regimes for the majority of the period in question. These include Australia, Brazil, Canada, France, Germany, India, Indonesia, Italy, Japan, South Korea, Mexico, Philippines, Thailand, South Africa and Switzerland.

The cost of capital is captured by a weighted average of Central bank policy rates and 10-year government bond yields, weighted by the share of bank and market-based credit in total credit to the private non-financial sector.

The pooled mean-group estimator developed by Pesaran, Shin and Smith, 1999⁷² is employed to understand the long-run impact of these drivers on the interest rate.⁷³ The equation below captures the long-run relationship between interest rates and their drivers. The drivers of capital cost in the long run are given by the current account balance (CAB as a percentage of GDP), government debt (as a share of GDP), the extent of financial deepening measured by credit to the private sector (as a percentage of GDP), and GDP growth. Further, short-run interest rates are used to capture synchronous, cross-country monetary policy shifts which influence the trajectory of long-term interest rates. Finally, a trend term is incorporated to absorb global structural factors that may uniquely influence long-term rates (such as demographic factors, shifts in inflation expectations and rising demand for long-duration assets).

$$\Delta i_{it} = \alpha_i \text{govtdebt}_{i,t-1} + \beta_i \text{CAB}_{i,t-1} + \gamma_i \text{findepth}_{i,t-1} + \text{GDP growth}_{i,t-1} + \eta_i s_{i,t-1} + c_i \text{trend}_{i,t-1} + \mu_i + \epsilon_{i,t}$$

71 See for instance, Ben Salem, M., & Castelletti-Font, B. (2016). Which combination of fiscal and external imbalances to determine the long-run dynamics of sovereign bond yields. <https://tinyurl.com/242r9du6>.

72 Pesaran, M. H., Shin, Y., & Smith, R. P. (1999). Pooled Mean Group Estimation of Dynamic Heterogeneous Panels. *Journal of the American Statistical Association*, 94(446), 621–634. <https://doi.org/10.1080/01621459.1999.10474156>.

73 The pooled-mean group estimation proves particularly useful for the analysis at hand, as it separates short-run country-specific effects from long-run patterns displayed across countries globally.

The results, reported in Table III.1, suggest that a one percentage point improvement in a country's CAB leads to a 2.8 basis point reduction in interest rates in the long run, while a one percentage point increase in private credit to GDP results in a 1.1 basis point decrease in rates. Thus, for the sample studied, improvements to the CAB proved nearly twice as effective in lowering the cost of capital over time as compared to financial deepening.

Table III.1 – Impact of independent variables on long-run interest rates

Independent Variable	Co-efficient
Current Account Balance	-2.8 bps**
Government Debt	+0.6 bps***
Financial depth	-1.08 bps***
GDP growth	0.67 bps**
Short-term interest rates	93.6 bps***
Trend	2.68 bps***

Note: '**', '***' denotes significance at the 5 per cent level and 1 per cent level, respectively.

Policy Implications for India

The capacity to generate domestic savings at scale ultimately depends on productivity, operating margins and retained earnings in the production system. Labour productivity shapes unit labour costs, which in turn influence competitiveness and profitability. Profitability, in turn, feeds into retained earnings and corporate savings, and together with household savings, these constitute the pool of loanable funds that financial markets allocate. Where productivity and margins are thin, retained earnings are weak, corporate savings are low, and the economy becomes more reliant on external capital, raising the equilibrium cost of capital.

Rigidities in labour regulation and firm-scale dynamics have historically constrained capital deepening, learning by doing, and the movement of firms up the productivity ladder. Firms have often responded by remaining sub-scale or informalised to preserve flexibility, but this comes at the cost of productivity growth and margin durability. Alternatively, firms have sought protection from import competition to preserve their margins, but often to the detriment of their downstream competitiveness. The profitability thus generated has not been reinvested in productivity and innovation to the same extent, thereby hindering external competitiveness. The consequence is not simply slower manufacturing expansion, but an entrenched weakness in generating external surpluses, reinforcing reliance on foreign savings at the margin.

Historical experience across late-industrialising economies suggests that durable declines in capital costs tended to follow, rather than precede, periods of productivity-led expansion in manufacturing, sustained export growth and the emergence of external surpluses. In such phases, aggregate demand is supported by exports, inflationary pressures are more

contained, expectations of exchange-rate depreciation are lower, and the risk premium embedded in capital costs declines.

By contrast, growth patterns that rely disproportionately on domestic demand and credit-enabled consumption, without commensurate productivity and export gains, may raise near-term activity but do not materially strengthen surplus formation. In a structurally savings-short setting, this configuration tends to sustain a weaker currency and rollover-risk premium in domestic capital costs.

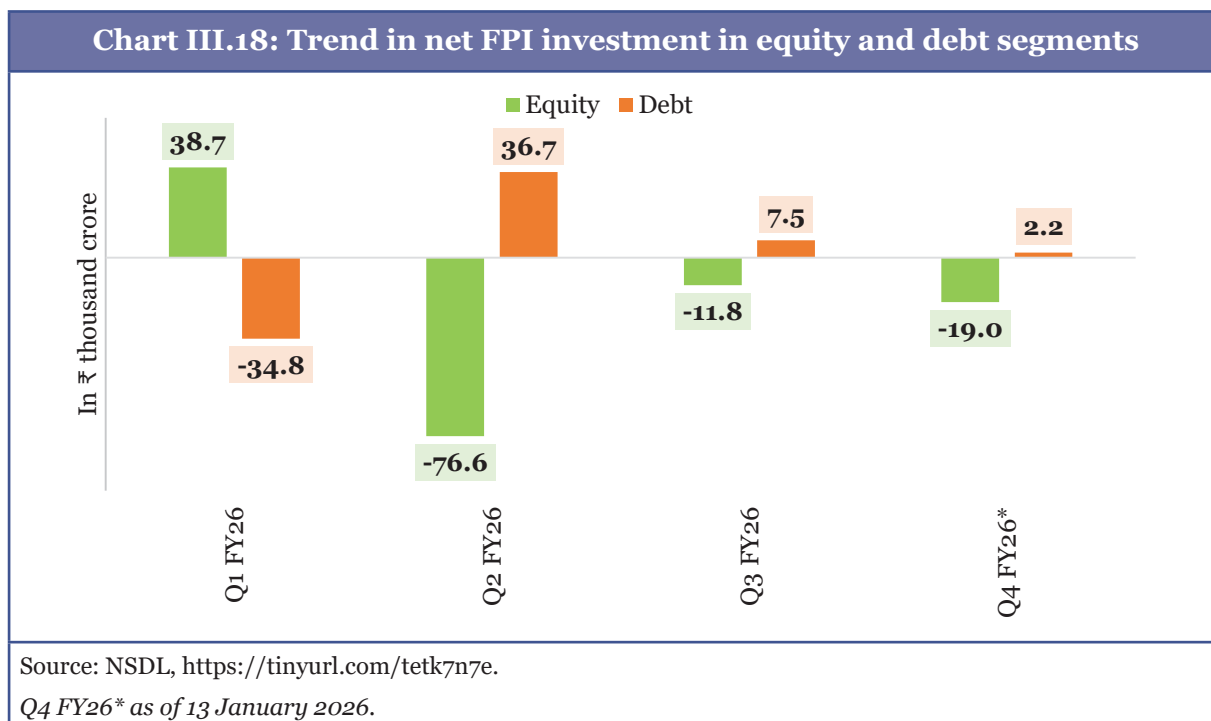
Financial-sector reforms remain important. Deeper bond markets, broader institutional participation, credible benchmarks and improved risk pricing can reduce intermediation costs and improve capital allocation. However, such reforms are most effective in environments where domestic savings are increasing and the external position is improving. Greater reliance on foreign capital can bridge temporary gaps but, when persistent, tends to elevate risk premia and narrow policy space—outcomes that are already reflected in the pricing of capital in CAD economies.

The strategic implication is that reducing India's cost of capital requires attention not only to financial intermediation but also to the drivers of production, exports, and surplus generation. Policies that support firm-level scale and deregulation, improve logistics, infrastructure, and trade facilitation, deepen technological capabilities and R&D, and enable sustained participation in global value chains can strengthen productivity and margins in manufacturing. As firms retain more earnings, corporate savings rise. As exports expand and trade and current account surpluses emerge and stabilise, dependence on foreign savings diminishes, expectations of depreciation moderate, and the external-balance component of the risk premium embedded in capital costs falls over time.

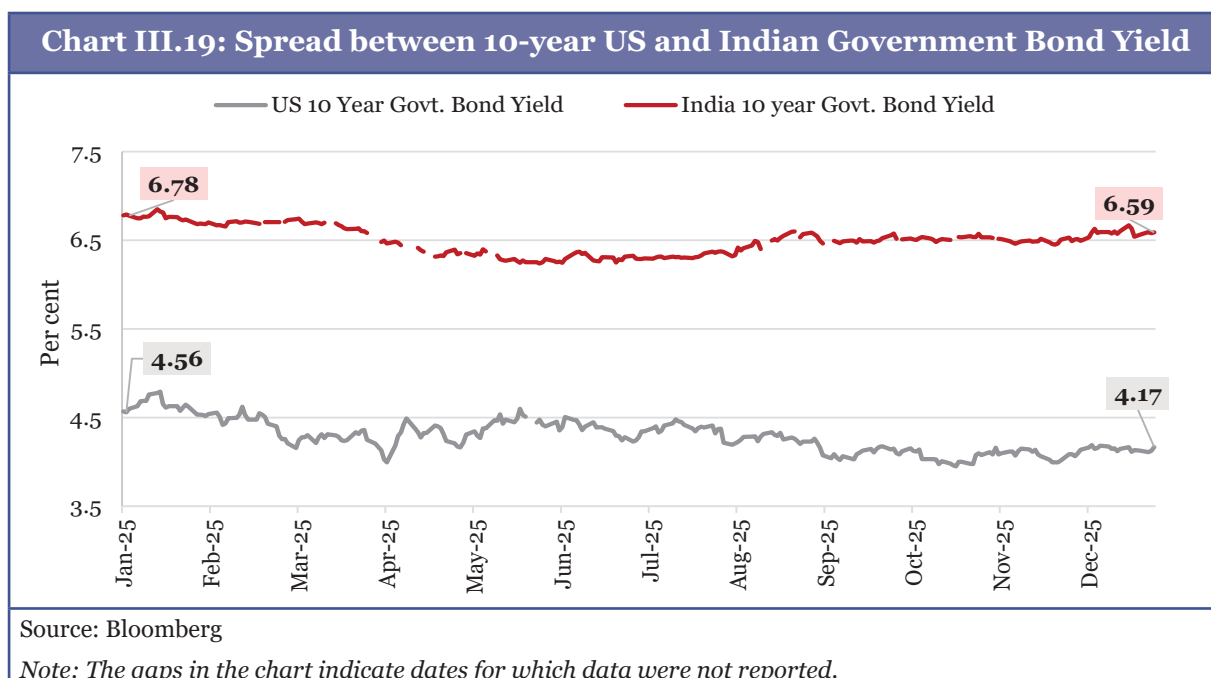
The durable route to a lower cost of capital is therefore inseparable from a growth pattern anchored in higher productivity, enhanced manufacturing competitiveness, sustained export growth, and the gradual transition from structural savings deficit to structural savings strength. Financial deepening can support and accelerate this transition, but it cannot substitute for it. Indeed, these are the recurring messages that run throughout this Economic Survey.

Foreign Portfolio Investment

3.86 India's Foreign Portfolio Investment (FPI) trends in FY26 exhibit volatility. During Q1 FY26, FPIs were net buyers of Indian equities and net sellers of debt instruments. In contrast, in Q2 FY26 and Q3 FY26, they transitioned from being net buyers of equities to net sellers, while being net buyers of debt instruments. As of 13 January 2026, FPIs are net sellers of Indian equities with outflows amounting to ₹16.5 thousand crore.



3.87 Overall, FPIs were net sellers of Indian securities from April to December 2025. The relative underperformance of Indian equities compared to other major markets, alongside trade and policy uncertainties, the depreciation of the Indian rupee, and a broad-based global risk-off sentiment amid elevated U.S. bond yields, weighed on FPI flows. These factors dampened sentiment towards Indian equities, particularly export-oriented sectors such as IT and healthcare, resulting in continued FPI outflows in FY26 (April-December).

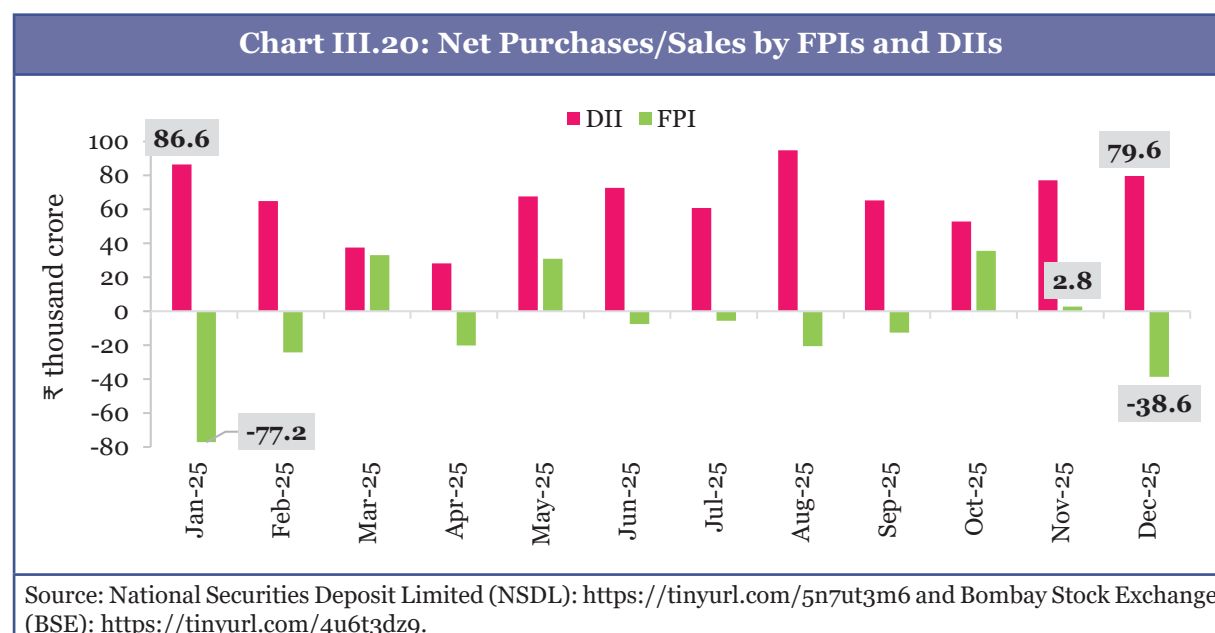


3.88 In late May 2025, the spread between 10-year Indian and US government bond yields narrowed to 165 basis points amid a stronger US dollar and falling Indian yields, reducing the relative attractiveness of Indian debt. However, by the end of 2025, as Indian yields rose and the dollar weakened, the spread widened to 250 basis points, improving the appeal of Indian bonds. Supported by SEBI's relaxation of FPI investment norms and ongoing India-US trade discussions, the outlook for FPI inflows into India's debt market remains positive.

3.89 As of 31 December 2025, the asset base under custody of FPIs stood at ₹81.4 lakh crore, marking a 10.4 per cent increase over March 31, 2025, driven largely by valuation gains in equities and steady accumulation in debt holdings.⁷⁴ Within NSE-listed equities, however, the share of FPI ownership declined to 16.9 per cent (for Q2 FY26), in line with global risk aversion and sectoral reallocations.

Domestic Institutional Investors: Counterbalancing FPIs

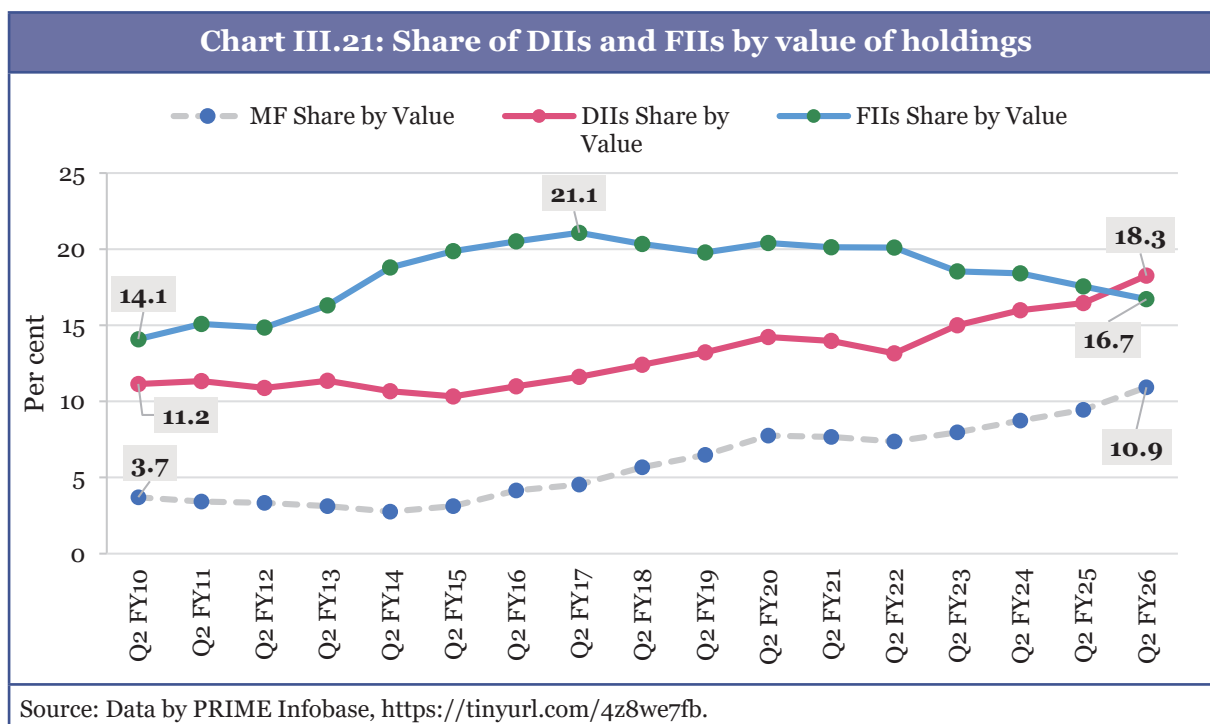
3.90 In the midst of volatile foreign capital flows, domestic institutional investors (DIIs), particularly mutual funds and insurance companies, have counterbalanced the volatility of foreign investment outflows and have provided much-needed support to the markets. With continued buying, as of 30 September 2025, DII ownership within NSE-listed equities stands at 18.7 per cent.⁷⁵



⁷⁴ NSDL: FPI AUC category-wise data, <https://tinyurl.com/mpmtv65v>.

⁷⁵ National Stock Exchange of India Limited. (2025, September). India ownership tracker: Q2 FY26 (Vol. 7, Issue 2): Who owns India Inc.? DMFs extend record run, FPIs at 15-year lows (Report), <https://tinyurl.com/mt9t6586>.

3.91 The DIIs have consistently maintained their position as net buyers in Indian equities, effectively countering FPI selling and reinforcing the strength of the domestic market. The increasing significance of DIIs as large net buyers is further reflected in their rising shareholdings. The share of DIIs⁷⁶ (by value of holdings) surpassed that of foreign institutional investors (FII)⁷⁷ for the first time in Q4 FY25 and has now reached an all-time high in Q2 FY26. In Q2 FY26, the share of DIIs (by value of holdings) stands at 18.3 per cent while that of the FIIs stands at 16.7 per cent, a 13-year low.⁷⁸



3.92 Domestic MFs have significantly contributed to the trend of the share of DIIs surpassing that of FIIs. In Q2 FY26, the share of MFs (by value of holdings) reached an all-time high of 10.9 per cent. Therefore, even though FIIs remain important participants in the Indian capital market, DIIs, along with retail investors and high-net-worth individuals, have been playing a strong counterbalancing role to the decisions made by FIIs regarding market participation. The combined share (by value of holdings) of DIIs, retail investors, and high-net-worth individuals reached an all-time high of 27.8 per cent in Q2 FY26.

⁷⁶ Domestic Institutional Investors include domestic MFs, Insurance Companies, Banks, Financial Institutions, Pension Funds, Non-Banking Financial Companies (NBFCs), Domestic Sovereign Wealth Funds (SWFs), Asset Reconstruction Companies (ARCs), etc.

⁷⁷ Foreign Institutional Investors include Foreign Portfolio Investors (FPIs), Foreign Direct Investment (FDI), Foreign SWFs and ownership through Depository Receipts (DRs) held by custodians.

⁷⁸ Data from PRIME Infobase is available at <https://tinyurl.com/4z8we7fb>.

GIFT City

3.93 The present era is characterised by intensified competition to attract global capital, with both developed as well as developing countries vying for productive capital to fuel their growth. While financial centres were an innovation of the era of globalisation, their relevance is exalted in the presence of intensified competition to attract global capital. In this context, the achievements and progress made by India's maiden International Financial Service Centre (IFSC) at GIFT City (Gandhinagar) provides a glimpse into India's advancements toward creating an enabling ecosystem for attracting and channelling global capital.






3.94 The International Financial Services Centres Authority (IFSCA), established in April 2020 under the IFSCA Act 2019, serves as GIFT City's unified regulator with a mandate to develop and regulate financial products, services, and institutions within the IFSCs. By consolidating regulatory powers previously dispersed across RBI, SEBI, Insurance Regulatory Development Authority of India (IRDAI), and Pension Fund Regulatory and Development Authority (PFRDA) for IFSC operations, IFSCA enables a cohesive regulatory approach aligned with international standards.

3.95 Prior to GIFT City's establishment, many Indian companies raised funds or managed offshore investments through jurisdictions such as Singapore, Mauritius, and the Cayman Islands, largely due to more favourable tax and regulatory frameworks. The IFSC architecture aims to bring back financial services transactions currently conducted outside India by overseas financial institutions and overseas branches of Indian financial institutions to Indian shores, thereby attracting multinational banks, investment funds, and technology firms to generate high-value jobs, draw global capital, and reduce financial outflows to offshore centres.

3.96 GIFT City has shown a strong growth momentum, with over 1,034 domestic and international entities registered across various categories as of 30 November 2025.⁷⁹ Within a year, GIFT City has moved up nine places in the Global Financial Centres Index (GFCI), reaching a rank of 43 out of 120 financial centres. Within the fintech-specific ranking, GIFT City improved by ten places, reflecting progress made through a dedicated regulatory framework for fintechs, academic partnerships and innovation centres. Table III.2 presents the major financial operations in GIFT City and their achievements to date.

⁷⁹ Including in-principle/ provisional registrations

Table III.2: Progress card of the major financial operations performed by GIFT City

Financial operations in GIFT City	Achievements
 Banking and credit operations	38 IFSC Banking Units with USD 100+ billion assets; USD 142.98 billion cumulative transactions. ⁸⁰
 Capital markets and debt	Monthly turnover USD 88+ billion; cumulative derivatives trades USD 1,351 billion; debt listings USD 66+ billion, including USD 15+ billion ESG securities.
 Specialised financial services	33 aircraft lessors (303 aviation assets) and 34 ship lessors (28 vessels) address India's leased fleet dependency.
 Bullion trading	The India International Bullion Exchange has been operational since July 2022, with 185 qualified jewellers and a vault capacity of 151 tonnes of gold and 930 tonnes of silver.
 Fund management and Insurance	194 Fund Management Entities managing 310 schemes; USD 26.30 billion commitments; 52 insurance entities registered.

3.97 Recognising that human capital underpins financial sector growth, two Australian universities have established operational International Branch Campuses in GIFT IFSC, offering master's programs in business analytics, cybersecurity, fintech, and computing. Two UK universities have received in-principle approvals to establish similar campuses.

3.98 Two developments in 2025 underscore GIFT City's growing regional and operational significance. In June, Sri Lanka's DFCC Bank listed Sri Lankan Rupee 2.5 billion in green bonds on the NSE International Exchange—the first listing by a foreign corporation on a GIFT IFSC exchange, signalling the centre's emergence as a regional capital-raising hub. The Foreign Currency Settlement System (FCSS), launched in October 2025, enables the local settlement of foreign-currency transactions between IFSC banking units without routing them through overseas correspondent banks. The FCSS operates on a real-time or near real-time basis, substantially reducing settlement times while enhancing transaction security and cost-effectiveness. This infrastructure positions GIFT City for future innovation in cross-border payments.

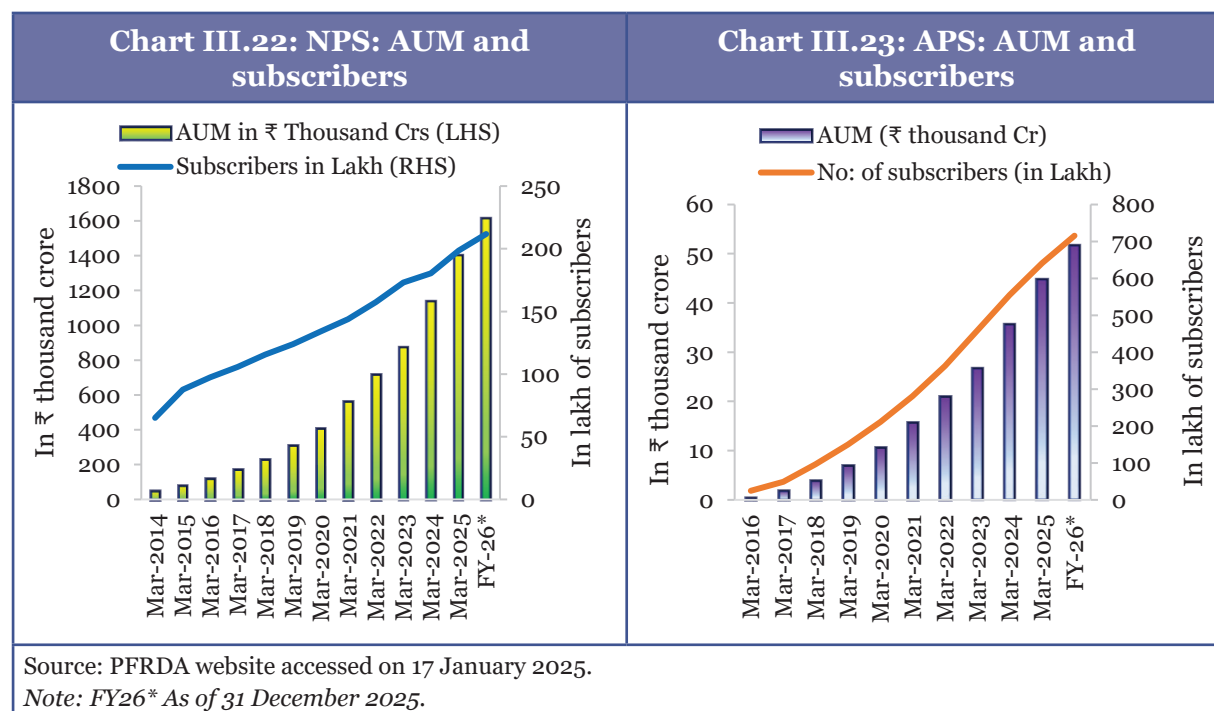
⁸⁰ PIB Press release Smart Finance, Smart Future: GIFT City, dated 28 November 2025, <https://tinyurl.com/bdew863h>.

Performance of the pensions sector

3.99 Between 2021 and 2036, the proportion of the old-age population (60+) in the total population is expected to increase from 10.1 per cent to 14.9 per cent. At the same time, the proportion of the working-age population (15-59) is projected to increase marginally from 64.2 per cent to 64.9 per cent during the same period.⁸¹ As today's workers approach retirement, it is essential that they be covered by a stable and secure pension scheme. In this context, the PFRDA has laid the groundwork for a vibrant pension system, offering a range of options for its users and covering a broad population bracket.

3.100 India's pension landscape features a multi-tiered system dominated by the market-linked National Pension System (NPS), the government-backed Unified Pension Scheme (UPS) launched in 2025, and other schemes like the Employees' Provident Fund (EPF) and Atal Pension Yojana (APY) for broader coverage.

3.101 The NPS architecture caters to a wide range of demographics: central and state government employees, private sector workers, corporate entities, minors under the NPS Vatsalya and individuals from the unorganised sector. As of 31 December 2025, there were 211.7 lakh subscribers to NPS and managed assets worth ₹16.1 crore.⁸² Over the past decade (FY15 to FY25), NPS subscribers have grown at a CAGR of 9.5 per cent, and the assets under management (AUM) have rapidly increased at a CAGR of 37.3 per cent.



81 Table 17: National Commission on Population, Ministry of Health & Family Welfare, Government of India. (2020). Population projections for India and states 2011–2036: Report of the Technical Group on Population Projections (July 2020). Ministry of Health & Family Welfare, Government of India, <https://tinyurl.com/msbyswy>.

82 NPS Trust website accessed on 17 January 2025, <https://tinyurl.com/bdtzkukv>.

3.102 The APY, which envisions a social security system for all citizens, is open to all Indian citizens who hold a savings bank account. Since its inception in 2016, APY subscriptions have grown at a robust CAGR of 43.7 per cent, and AUM have shown exemplary growth at a CAGR of 64.5 per cent.

3.103 The government introduced the UPS vide notification dated 24 January 2025, as an option under the NPS for Central Government employees. It aims to blend the best features of previous systems by guaranteeing a minimum pension and allowing investment-based growth, providing stability and flexibility for retirees.

3.104 NPS Vatsalya is a contribution-based saving-cum-pension scheme for minors, which aims not only to secure the future of its young subscribers but also emphasises the importance of nurturing a culture of savings from an early age.

3.105 PFRDA has introduced several pensions and retirement schemes specifically targeting platform (gig) workers and the agricultural (agribusiness) sector, aiming to widen the social security net and ensure financial security among India's informal workforce. The NPS e-Shramik (Platform Service Partner) Model was launched on 29 October 2025. This model is designed for platform workers and seeks to integrate them into mainstream retirement savings through the NPS.⁸³

3.106 PFRDA is partnering with Farmer-Producer Organisations (FPOs) and MSMEs to bring pension coverage to more workers in the agriculture sector, including farmers, FPO members, and participants of self-help groups. The focus is on enrolling agriculture workers under the NPS and the APY, both of which provide flexible, long-term retirement savings options, including a guaranteed pension under APY.

3.107 India's pension system has expanded steadily, yet overall coverage remains modest relative to the size of the workforce.⁸⁴ Additionally, persistent awareness gaps prevail, with low-income and rural households maintaining limited exposure to long-term retirement products.⁸⁵ Recent efforts, such as simplified onboarding, NPS Lite variants, APY outreach campaigns, and targeted products for minors, gig workers, and farmer groups, demonstrate the progress being made in closing these long-standing coverage gaps.

83 PFRDA. (2025, October 29). Inclusion of Platform Service Partner under the National Pension System (NPS) – “NPS e-shramik (Platform Service Partner) Model” (Circular No. PFRDA/2025/19/PDES/02), <https://tinyurl.com/5efwx6fp>.

84 Centre for Policy Research. (2022, January 17). The Pension Fund Regulatory & Development Authority, <https://tinyurl.com/ysta5v5w>.

85 Mohanty, D. (2025, January 17). Progress and prospects of pension in India (Speech). 17th Mint BFSI Summit & Awards, Mumbai, India. Pension Fund Regulatory and Development Authority, <https://tinyurl.com/3xhhjsse>.

3.108 The predominance of informality continues to be the central constraint on achieving broad-based pension inclusion. Moreover, households with irregular incomes face difficulty committing to locked-in, long-horizon savings, even when contributions are modest. Accessibility is improving with digital KYC, e-NPS, and integrations with payment platforms, but flexible contribution structures and intuitive product design remain essential for workers with volatile cash flows. The inclusion of pension systems through platforms and apps – now seen in the UK, Singapore, and Europe – demonstrates a viable route for increasing contribution compliance when pension deductions are embedded into existing digital work interfaces.⁸⁶

3.109 Adequacy and sustainability are becoming key priorities for the pension system as it expands over time. Global benchmarks, such as the Mercer CFA Global Pension Index, consistently rank India lower in terms of adequacy and system maturity, reflecting relatively low replacement rates and modest pension assets (around 17 per cent of GDP) compared to OECD peers (at least 80 per cent).⁸⁷ Pension assets in India make up around 15-20 per cent of GDP, significantly less than the 60-100 per cent range seen in more advanced pension markets.

3.110 An area for further progress is regulatory coherence. Studies highlight the need for better alignment between EPFO, PFRDA, and state-level pension bodies to reduce fragmentation, enhance portability, and streamline governance.⁸⁸ Strengthening actuarial evaluation frameworks, diversifying long-term investment portfolios, and deepening data-sharing mechanisms across institutions will be essential as longevity increases and old-age dependency continues its structural rise.

3.111 The way forward for India's pension ecosystem lies in a calibrated expansion of both contributory and non-contributory schemes. At the contributory end, simplifying enrolment through Aadhaar-based authentication, enabling frictionless micro-contributions via digital payments, and synchronising pension outreach with broader financial inclusion drives can help deepen penetration. Engagement with state governments, cooperatives, farmer networks, and gig-platform companies can ensure last-mile reach.

3.112 The introduction of UPS and NPS Vatsalya demonstrates adaptive policymaking that responds to evolving demographic and labour-market realities while maintaining

86 Pension Fund Regulatory and Development Authority. (2025, April 3–4). International research conference on pension (IRCP 2025): Records of discussion—IRCP-2025 (Conference report), <https://tinyurl.com/2rvauxx2>.

87 Pension Fund Regulatory and Development Authority. (2025). International Research Conference on Pension (IRCP 2025) [Conference proceedings]. Pension Fund Regulatory and Development Authority, <https://tinyurl.com/ydnmdvm7>.

88 Lodha, N., & Mukherjee, D. (2024, October 24). One Nation, One Pension System. Vidhi Centre for Legal Policy, <https://tinyurl.com/ya3rc467>.

long-term fiscal prudence. Continued innovation in service delivery, data integration and consumer guidance will be crucial for the next phase. Global experiences of developed pension systems underscore the value of lifecycle planning tools, personalised dashboards, and automated advisory nudges, all of which can be integrated into India's maturing digital public infrastructure.⁸⁹

3.113 Expanding interoperability across NPS, APY and other schemes will support seamless portability as workers shift sectors or migrate. Strengthening actuarial capabilities, improving risk-modelling frameworks, and promoting long-duration investment channels can enhance both resilience and returns. With sustained institutional strengthening, India is well-positioned to develop a pension system that is inclusive, future-ready, and anchored in global best practices.

Performance of the Insurance Sector

3.114 The Indian insurance sector is undergoing a significant transformation, driven by the vision of 'Insurance for All by 2047', where every citizen possesses appropriate life, health and property insurance cover. In alignment with this objective, the IRDAI has been implementing a series of regulatory reforms to foster growth and empower policyholders.

3.115 This sector has continued to widen its reach, reinforcing its role as a key mechanism for risk transfer and a vital channel for long-term savings mobilisation across households, enterprises, and the wider economy. With AUM reaching ₹74.4 lakh crore in FY25, the sector's financial depth has strengthened. Total premium income rose to ₹11.9 lakh crore in FY25 from ₹8.3 lakh crore in FY21. The life insurance segment dominates the landscape, holding 91 per cent of the total AUM and contributing approximately 75 per cent of the premium income. Structural shifts are evident in the 'non-life' insurance segment, where health insurance, accounting for 41 per cent of the gross domestic premium, has overtaken motor insurance as the leading business line. All 26 life insurers, 26 non-life insurers, seven health insurers and two specialised insurers are active and supported by a network of over 83 lakh distributors.

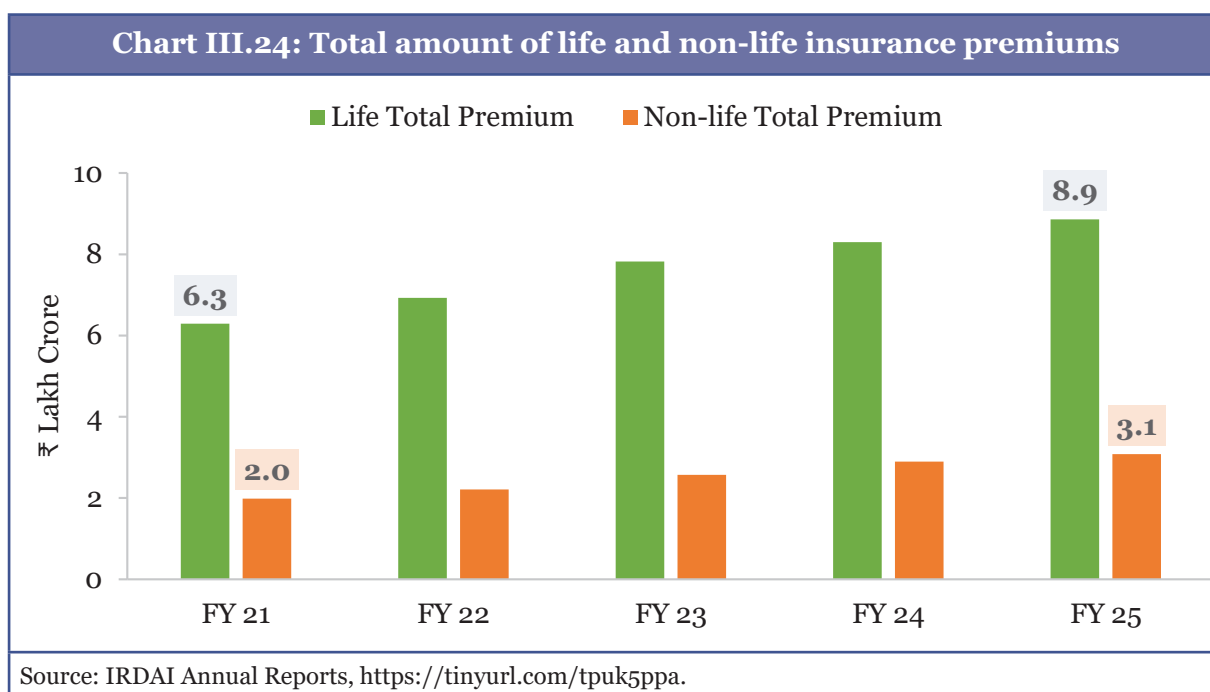
3.116 The sector demonstrated resilience in managing rising claims and liquidity demands. Life insurers paid benefits totalling ₹6.3 lakh crore in FY25. A compositional shift was observed in payouts, with surrender and withdrawal benefits rising to levels comparable to maturity payments. In the 'non-life' sector, net incurred claims escalated by over 70 per cent since FY21 to ₹1.9 lakh crore in FY25, primarily driven by the Health and Motor segments. To sustain this operational growth and absorb underwriting

⁸⁹ Organisation for Economic Co-operation and Development. (2024). OECD Pensions Outlook 2024: Improving asset-backed pensions for better retirement outcomes and more resilient pension systems (OECD Publishing), <https://tinyurl.com/yea29yd6>.

volatility, the equity share capital of the ‘non-life’ sector increased to over ₹43,000 crore, exceeding the Life sector’s base of ₹39,700 crore. This continuous capital infusion has ensured that both segments maintain healthy solvency margins.

3.117 Accessibility infrastructure has been bolstered through a strategic mix of physical presence of insurers and intermediary expansion. The total number of insurers’ offices stood at 22,076 as of March 2025. Complementing this physical reach, the distribution network—comprising agents, point of sales persons, and institutional partners—grew significantly from approximately 48 lakh in FY21 to nearly 83 lakh in FY25. This expansion is vital for facilitating delivery of insurance services various segments and specially in reaching the rural and socio-economically weaker sections of society.

3.118 The non-life insurance segment has recorded strong growth in recent years, broadly keeping pace with nominal GDP growth. This expansion has been driven by rising demand for health insurance, mandatory motor insurance requirements, and increasing asset ownership. Standalone health insurers have emerged as one of the fastest-growing segments, highlighting the growing need for healthcare financing solutions.



3.119 Despite the progress in Life and Non-life segments, insurance penetration remains low, resulting in a significant protection gap. Rapid escalation in healthcare costs, rising climate-related risks, and an increase in cyber-risk incidents have emerged as key challenges. A large proportion of households and MSMEs continue to remain uninsured, with insurance adoption uneven across regions and income groups. Closing

this protection gap is critical to strengthening household financial security and reducing vulnerability to financial shocks. Achieving this will require the insurance sector to grow at a substantially faster pace than nominal GDP.

3.120 The exemption in GST on life insurance and individual health insurance policies, introduced from September 2025, has provided substantial relief to policyholders and made insurance services more affordable in these two critical lines. Backed by such tailwinds, the growth is expected to pick up and add new insurance policyholders.

3.121 The enactment of ‘Sabka Bima, Sabki Suraksha Act, 2025’ will usher in the much-awaited reforms in the insurance sector. An increase in the FDI limit to 100 per cent, accompanied by other amendments, paves the way for ease of doing business, the entry of more players, and enables the much-needed expansion of the sector to address the protection gap for individuals and businesses. Increased penetration and a fast-growing insurance sector also imply the availability of long-term investable funds that support infrastructure growth. Box III.10 provides the key provisions of the Act.

Box III.10 Sabka Bima Sabki Raskha (Amendment of Insurance Laws)

The Sabka Bima Sabki Raksha (Amendment of Insurance Laws) Act, 2025 has amended various provisions of the Insurance Act, 1938, the Life Insurance Corporation Act, 1956, and Insurance Regulatory and Development Authority Act, 1999, with a view to enhance citizens protection, deepen insurance penetration, accelerate growth and development of the insurance sector and to enhance the ease of doing business. The Act was notified on 21 December 2025. Important provisions are as below:

- **Increased FDI limit:** The amendment has raised the FDI limit in Indian insurance companies from 74 per cent to 100 per cent. This will help in attracting stable and sustainable investment, facilitate technology transfer, enhance insurance penetration and social protection
- **Promote Ease of Doing Business:** To ensure uninterrupted service and support to policyholders and to promote ease of doing business, one-time registration of insurance intermediaries has been provided. Further, the limit for seeking IRDAI approval for transfer of shares of paid-up equity capital is has been raised from the current 1 per cent to 5 per cent for insurance companies. The requirement of Net Owned Funds for foreign reinsurers has been reduced from ₹5,000 crores to ₹1,000 crores to facilitate the entry of more reinsurers, thereby helping to build greater reinsurance capacities in the country.
- **Creation of Insurance Awareness:** The amendment provides for the creation of a Policyholders’ Education and Protection Fund, to increase citizens’ awareness towards risk protection and promote education for policyholders

- **Improved Policyholders' Protection:** For greater Policyholders' protection, IRDAI has been granted the power of disgorgement of wrongful gains made by an insurer or intermediary. The maximum penalty limit for insurers who default in complying with or acting in contravention of the Insurance Act or the IRDAI Act has been increased from ₹1 Crore to ₹10 Crore. Insurance intermediaries have also been included under this provision. This would act as a deterrent and encourage legal and regulatory compliance.
- **Alignment with Digital Personal Data Protection Act 2023:** The amendment creates a legal anchor for effective use of digital public infrastructure in the insurance sector to ensure that policyholders' information is duly secured and protected.

Furthermore, the Indian Insurance Companies (Foreign Investment) Amendment Rules, 2025, were also notified on 30 December 2025 to facilitate ease of doing business by rationalising the conditions for Indian insurance companies and insurance intermediaries.

3.122 For creating a universal social security system for all Indians, especially the under-privileged, two social security schemes in the insurance sector are in place, viz, Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY) and Pradhan Mantri Suraksha Bima Yojana (PMSBY), on a pan-India basis since May 2015. The schemes are being offered by public sector insurers and other insurers that are offering the product on similar terms, with the necessary approvals and tie-ups with banks and post offices for this purpose. As of 7 January 2025, cumulative enrolment under PMSBY and PMJJBY is 56.15 crore and 26.32 crore, respectively. Further, 1.73 lakh and 10.24 lakh claims have been paid under PMSBY and PMJJBY, respectively.

Structural Challenges: High operating costs

3.123 While the sector has continued to grow at a robust pace, operational cost dynamics have continued to change within the insurance industry. Escalating acquisition and administrative costs have resulted in increased operating expenses for insurers across both life and non-life insurance segments.

3.124 Despite the push for digital transformation, customer acquisition continues to depend heavily on expensive intermediary networks. Consequently, instead of technology leading to cost rationalisation, costs have steadily increased, with a significant portion of premiums being consumed by distribution overheads.

3.125 The most visible implication of the high-cost regime is the widening divergence between insurance coverage depth and breadth. While insurance density has risen steadily to USD 97 in FY25, reflecting higher spending by households already integrated into the financial system, insurance penetration has stagnated and declined to 3.7 per cent. This paradox indicates that while the sector is successful in 'deepening' revenue

from existing customers, high distribution costs are preventing a ‘widening’ of the risk pool. The rigid cost structure means premium growth fails to keep pace with nominal GDP, eroding the sector’s relative economic size. Lowering overall costs and distribution outgoes is essential to improve affordability, enabling the industry to tap into the ‘missing middle’ and reverse the decline in penetration.

3.126 The escalating cost of acquisition is not merely an operational friction; it acts as a structural constraint on the sector’s evolution, creating distortions that limit inclusion, erode consumer value, and threaten long-term stability. Rationalising this cost structure is the critical lever required to transition the industry from a ‘high-cost, low-penetration’ equilibrium to a sustainable growth path.

3.127 The high-cost model poses a risk to the core financial strength of insurers. Private life insurers, despite robust topline growth, have seen their net profit stagnate, as margins are compressed by escalating acquisition expenses. Similarly, the non-life sector faces high combined ratios, forcing a heavy reliance on investment income to subsidise operations, a strategy that exposes the sector’s bottom line to capital market volatility. Rationalising acquisition costs would allow insurers to price risk more accurately and increase value to customers, making products and prices more affordable.

3.128 The insurance sector stands at a pivotal juncture. While it has matured into one of the economy’s deepest institutional pools of long-term capital, it remains constrained by a ‘low-penetration, high-cost’ equilibrium driven by a high-cost distribution model that has inflated the cost of protection, structurally limiting the sector’s reach despite its robust solvency and balance sheet strength. The path forward necessitates decisive shifts. Insurers must prioritise the digitisation of distribution to rationalise acquisition costs and restore ‘value for money’ to the policyholder. If the industry can successfully dismantle these cost inefficiencies, it will not only resolve the penetration-density paradox but also transform from a constrained aggregator of savings into a truly inclusive and resilient pillar of the economy.

CONCLUSION

3.129 In an era characterised by heightened global uncertainty, geopolitical flux, and rapid technological transformation, the quality of financial sector regulation has emerged as a critical determinant of economic resilience and sustained growth. India’s financial regulatory architecture demonstrates a clear recognition of this imperative, as evidenced by RBI’s landmark framework for the formulation of regulations issued in May 2025. This framework institutionalises a transparent, consultative, and impact-driven

approach to regulation-making, one that incorporates periodic reviews, stakeholder engagement through the Advisory Group on Regulation, and a dedicated Regulatory Review Cell tasked with systematically examining each regulation at least once every five to seven years. Such measures signal a paradigm shift from reactive regulation to proactive, anticipatory governance that can respond dynamically to evolving market conditions and global best practices. SEBI has demonstrated a parallel commitment to regulatory modernisation and investor protection.

3.130 India's regulatory bodies for insurance and pension - IRDAI and PFRDA - have similarly advanced reforms to deepen financial inclusion and extend protection to underserved segments. IRDAI has transitioned towards a principle-based framework that consolidates regulations, reduces compliance burdens, and provides insurers with greater flexibility to innovate. Meanwhile, the Sabka Bima Sabki Raskha (Amendment of Insurance Laws) represents its commitment to digitising the insurance ecosystem and democratising coverage. PFRDA, meanwhile, has focused on widening the social security net to encompass India's vast informal workforce - the NPS e-Shramik model, launched in October 2025, integrates platform and gig workers into mainstream retirement savings, while partnerships with FPOs and MSMEs extend pension coverage to agricultural workers and self-help group participants through the NPS and APY.

3.131 The systemic rise in regulatory quality has received international validation through the Financial Sector Assessment Program (FSAP) conducted jointly by the IMF and World Bank in 2025.^{90,91} Both reports noted an increasingly resilient, diversified, and inclusive financial system, with total financial sector assets at nearly 187 per cent of GDP in CY 2024 and capital markets expanding from 144 per cent of GDP in CY 2017 to 175 per cent in CY 2024. The assessments found that banks and NBFCs possess adequate capital buffers even under severe stress scenarios.

3.132 In today's era, India's financial sector regulators must walk the tightrope to balance growth with stability. They must strike a balance between openness to global capital flows and the need to insulate the domestic economy from volatile external shocks. Moreover, given India's heterogeneous financial landscape, where sophisticated metropolitan markets coexist alongside underserved rural segments, regulators must exercise differentiated supervision: a shorter leash for emerging or fragile segments prone to excessive risk-taking and greater latitude for mature markets. In this context, so far, India's financial sector regulators have managed the balancing act deftly. Box III.11 discusses how the regulatory system must evolve towards proportionality, contestability, and risk-appropriate supervision without compromising stability.

90 World Bank. (2025). India financial sector assessment: Financial Sector Assessment Program (FSAP) update (June 2025), <https://tinyurl.com/y4zd79a>.

91 International Monetary Fund. (2025). India: Financial Sector Assessment Program—Financial System Stability Assessment (IMF Country Report No. 25/55), <https://tinyurl.com/5h6ecbn6>.

Box III.11: Finance for growth: paving the way for Viksit Bharat

India's aspiration to become a Viksit Bharat by mid-century demands a fundamental rethinking of finance, not merely as funding, but as the architecture of economic transformation. Finance, in its broader institutional and behavioural sense, governs how effectively capital is mobilised, allocated, and sustained across the economy. It is the central enabler. When finance builds trust, fosters competition, and enables innovation, it becomes the catalyst of development.

A nation does not develop by spending more but by expanding its productive base—enabling firms to invest and scale, households to earn and save securely, and markets to channel capital efficiently. This requires an enabling environment: rational taxation that supports enterprise, regulators that foster competition, financial markets that deepen and diversify, and administrative systems that operate transparently and promptly. Finance for Viksit Bharat is therefore about shaping conditions that generate and deploy resources efficiently.

Fostering certainty and predictability

This requires tax systems that are simpler and service-oriented, dispute resolution that is time-bound and fair, and the decriminalisation of technical offences. Regulators must promote competition and innovation while safeguarding stability. Credit and capital supply must move beyond bank dominance through deeper markets and modern financial infrastructure. Administrative processes should be centred on timeliness, proportionality, and citizen service.

Recasting financial regulation

Finance influences growth most visibly through regulation. Historically, India has placed a premium on banking system stability. As a result, long-term financing channels. Banks remain dominant, despite not being adequately equipped to finance infrastructure, energy transition, and large manufacturing projects with long horizons. India's development aspirations require a diversified ecosystem where well-managed banks compete alongside NBFCs, fintechs, and market-based lenders. Diversification distributes risk and builds resilience, lessening vulnerability to shocks.

Diversified financial ecosystem calls for regulatory coordination, as, currently, India's financial system is supervised by domain-specific regulators. Financial innovation increasingly blurs these boundaries. Banks distribute insurance and mutual funds; NBFCs perform functions similar to those of banks; fintechs intermediate credit and payments. To avoid regulatory arbitrage, inconsistency, and enforcement blind spots, regulation should shift from entity-based to activity-based frameworks, focusing on the risk and function of transactions rather than institutional labels. When entities engage in similar activities, they should face proportionate regulatory oversight based on their risk exposure. This promotes equality of treatment, competition, and innovation while ensuring systemic stability. Finally, enhanced inter-agency coordination is crucial for effective oversight of increasingly complex and interconnected financial entities.

India's regulatory framework hitherto has rightly emphasised stability and systemic safety. The goal now must be to proportionality-calibrate regulation to risk and contestability, ensuring fair competition across entities and activities. The shift towards proportional, consultative, and accountable regulation is exemplified in the proposed Securities Markets Code, 2025 (Box III.6).

Deepening long-term finance

To finance sustained growth, India must strengthen long-term capital markets. Corporate bond markets remain shallow and illiquid, dominated by top-rated issuers. Securitisation is limited, municipal bonds are underdeveloped, and pension and insurance funds remain conservative investors due to regulatory and cultural inertia. A coordinated agenda could address these barriers by:

- Rationalising tax treatment of debt instruments.
- Creating credit enhancement facilities for lower-rated issuers.
- Standardising securitisation structures and disclosures.
- Building municipal financial capacity and pooled bond mechanisms.
- Revising investment guidelines for long-term funds.
- Strengthening financial market infrastructure and insolvency systems.

Such reforms would supply the scale and maturity needed for infrastructure and climate financing while lowering the economy's cost of capital.

Building a balanced financial ecosystem

The reforms taken together aim to shape a financial system that is stable yet competitive, diversified yet resilient, and innovation-friendly yet safe. Banks will remain central, but they must be seen as one part of a richer ecosystem that includes non-bank intermediaries and markets. Such a system reduces capital costs, expands financing options, facilitates structural transformation, and enhances the economy's adaptive capacity.
