MARCH 2023

IBS VIGYAN

VISIONING BANKERS

Evangelistically Speaking

Dear Stakeholders,

As the financial year winds up, bank chiefs will be anxiously observing the yield curve of balance sheet date and the quantum of depreciation on the investment portfolio that it's shape will bring with it. From the present 7.35%, will the ten-year benchmark slide higher to 7.50% or settle lower at 7.25% amidst its teetering journey during the last week of this month? The availability of software to compute the marked-to-market position on a daily basis and the stress testing exercises that banks have been undertaking as part of their risk management functions would have for sure, left the bank chiefs reassured of the extent of dent on their bottom-line from market risk.

It is against this background that we need to learn from the string of bank failures in US and the Zurich-based Credit Suisse. While the narratives that trace the cause for failures may differ, suffice it to state that the regulatory oversight needs to be examined with greater scrutiny. The responses from the regulators have been copy book style in protecting the banks' liabilities to unsecured depositors. Resultantly, the ten-year benchmark US Treasury bond yield retraced from the highs of 4% to 3.50% and gold prices hardened. The renewed bonhomie between Saudi Arabia and Iran brokered by China has softened the price of crude.

It is contextual that RBI has published draft guidelines on minimum capital requirements for market risk. The flexibility to shift securities from Held To Maturity (HTM) to Available For Sale (AFS) would stand withdrawn, save some compelling circumstances, where RBI permission would be needed. On the same day of publishing these draft guidelines, 17th February 2023, RBI has also published revised guidelines on measuring Interest Rate Risk on Banking Book. The enhanced rigour in both these approaches must bolster the resilience of banks to withstand market risk related shocks. Therefore, this month's Curated Cube articulates on these developments.

The response from career aspirants enrolling for the ensuing examinations of IIBF has been encouraging, in terms of equipping themselves with knowledge on the augmented content across all modules of the courses. Our engagements with the candidates have also been stepped up to meet these challenges.

Looking forward to a sustaining engagement with you.

Sincerely Yours

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Curated Cube

The Silicon Valley Bank ran basis risk (asset – liability mismatch). The Signature Bank ran concentration risk. The Credit Suisse followed dubious accounting and risk management practices. The means were diverse, the end was same. They met with their end. The regulator and government in US and Switzerland had to step in to assuage the apprehensions of depositors. The bolstering statements from the governments came with some delay, which eroded market wealth of equity investors in these banks.

In 2008, the Lehman Brothers folded up. Northern Rock Bank folded up. The Basle Committee for Bank Supervision (BCBS) analysed the causes and introduced Capital Conservation Buffer (CCB) as additional Common Equity Tier 1 capital to enhance banks' capability to withstand market risk related shocks. Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) were designed to position banks to face liquidity shocks.

Subsequent to the shocks in 2023, it is apposite that BCBS review the prescriptions on defining market risk and recommend more rigorous computation methodologies for capital charge. Meanwhile RBI has published two documents on 17th February 2023. One is the daft guidelines on minimum capital requirements for market risk. This attempts to redefine trading book and banking book. Resultantly, banks will not be able to shift securities from Held To Maturity (HTM) to Available For Sale (AFS) as is permissible every year now. But this shall not constrain a bank's opportunity to book profits by selling securities from HTM portfolio. Therefore, neither the Post-Tax profit nor the Dividend Pay-out Ratio of the bank will be affected. A Scaling Factor of different magnitudes has been introduced for interest rate instruments, equities and forex positions while computing capital charge for market risk. This will elevate the market risk charge number.

The revised guidelines on Interest Rate Risk on Banking Book (IRRBB) will phase out the duration gap analysis approach. Instead it will look at economic value-based measure ∆EVE (Economic Value of Equity) and earning-based measure ∆NII (Net Interest Income). Banks will compute the change in EVE under six RBI prescribed shocks. They will also compute the change in NII for two of the six shock parameters. If the ∆EVE exceeds 15% of capital, certain action responses will be triggered like raising capital, reducing IRRBB and the like.

These measures must ringfence our banks from any contagion from overseas bank failures.

(Cube gives a third dimension in geometry. Curated Cube endeavors to conflate events in the market over the past month.)

OUR JAIIB/CAIIB CLASSES ARE ON IN FULL SWING

FOURTH PILLAR

SAPTARISHI IN THE BUDGET 2023-24: While presenting the Union Budget, the finance minister laid down 7 pillars to usher growth and development in our economy and named it as Saptarishi. The pillars are (i) Inclusive Development (ii) Reaching Last Mile (iii) Infrastructure Investment (iv) Unleashing Potential (v) Green Growth (vi) Youth Power and (vii) Financial Sector.

AGRICULTURE ACCELERATOR FUND: Under the inclusive development plan, for encouraging innovative start-ups in rural areas, a fund has been created in Union budget, which will aim at bringing innovative and affordable solutions for the challenges faced by farmers. It will also bring modern technologies to transform agricultural practices, increase productivity and profitability.

NATIONAL FINANCIAL INFORMATION REGISTRY: A central repository of financial and ancillary information for facilitating efficient flow of credit, promoting financial inclusion and fostering financial stability has been introduced during the current budget named National Financial Information Registry (NFIR).

DOMESTIC SYSTEMICALLY IMPORTANT BANKS (DSIBs): The RBI, in January 2023, announced that SBI, HDFC Bank and ICICI Bank to continue as DSIBs under the same bucketing structure as earlier. For such DSIBs and Global SIBs having operations in India, it is required to maintain additional CET1 capital as Countercyclical Conservation Buffer as under:

Bucket	Bank	% CCCB
5	-	1.00%
4	-	0.80%
3	SBI	0.60%
2	-	0.40%
1	HDFC & ICICI Bank	0.20%

IRIS SCAN & FACE RECOGNITION ALLOWED IN BANKS: A few banks have been permitted to use facial recognition and iris scan in certain cases to curb fraud and tax evasion. Customers who have not yet shared their PAN to the bank, these banks can use face recognition and iris scan to verify their identities of such customers who make transactions exceeding ₹20 lakh in a financial year and have only shared their Aadhar number to the bank.

(Fourth Pillar strives to position beyond the three pillars of Basel and is culled from the Four Estates)

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INQUISITIVELY SPEAKING

1. The RBI has issued revised guidelines on Foreign Exchange Management (Hedging of Commodity Price Risk and Freight Risk in Overseas Markets). As per the guidelines, RBI has permitted Generic products and Structured products. Which of the following is not the Generic product permitted by RBI:

a) Futures and forwards
b) Vanilla options (call option and put option)
c) Swaps
d) Forward Rate Agreement (FRA)

2. As per RBI guidelines regarding Sovereign Gold Bond Scheme, premature redemption of Gold Bond may be permitted after __ year from the date of issue of such Gold Bond on the date on which interest is payable.

a) Third
b) Fourth
c) Fifth
d) Seventh

3. RBI has recently released the revised list of domestic credit rating agencies for risk weighting claims for capital adequacy purposes. As per the revised list issued by RBI which domestic rating is not now approved rating agency:

a) Acuite Ratings & Research Limited (Acuite)
b) Credit Analysis and Research Limited (CARE)
c) CRISIL Ratings Limited
d) ICRA Limited
e) India Ratings and Research Private Limited (India Ratings)
f) INFOMERICS Valuation and Rating Pvt Ltd. (INFOMERICS)
g) Brickwork Ratings India Private Limited,

4. The finance ministry has modified the Emergency Credit Line Guarantee Scheme (ECLGS) by raising loan limit under the scheme to ₹ _____ crore from ₹400 crore to help the civil aviation sector tide over liquidity stress.

a) 500
b) 1000
c) 1500
d) 1800

ANSWER KEY

1. D 2.C 3.G 4.C

Stretch n Speak

FIRMS: Foreign Investment Reporting & Management System

GVA: Gross Value Added

PM-PRANAM: Prime Minister's Programme for Restoration, Awareness, Nourishment and Amelioration of Mother Earth.

ODOP: One District One Product

SCSS: Senior Citizen Savings Scheme