

INDIAN BANKING AGAINST GLOBAL BENCHMARKS

SYNOPSIS OF AN ARTICLE BY SHRI D. T. PAI-FORMER CMD OF SYNDICATE BANK

In an increasingly integrated and complex world market it is necessary that the Indian Banking System should compare its performance against the world benchmarks. Some important ratios are given below for an understanding as to what is the position of the health of Indian schedule banks vis-a vis the global banks.

Item	Global average	Indian average	International norm if any	RBI norm if any
CRAR	7.1% - 34.9%	12.3%	8%	9%
ROA	0.2% - 4.3%	0.9%	-	-
NII	1.2% - 6.2%	2.9%	-	-
CIR	0.46% -0.68%	0.5%	-	-
GROSS NPA	0.2% - 24.7%	2.8%	-	-
PROV. TO NPA	23.15 -229.1%	56.1%	-	-
CAP/ASSET	4%-22%	6.30%	-	-
VOLATILE LIAB./ASSETS	0.71% -0.11%	-17%	-	-

The Indian economy is fairly insulated from the global financial crisis at present since Indian banking system is not directly exposed to sub-prime US mortgage market or the failed institutions or their stressed assets in any significant way. The same is not the case with the liquidity since the overseas borrowing markets has shrunk. However, looking to the increasing depressed performance of the corporates in general banks are required to take care of their performance by imbibing more effective risk management tools and taking effective measures.

Learning points:

1. A comparative study of critical performance indicators of banks with global big banks which reiterates that Indian Banks are no inferior to global banks in performance
2. The need for introducing more effective risk management practices to withstand contagion impacts

CONVERGENCE TO IFRS- ISSUES FOR BANKING SECTOR.

Institute of Chartered Accountants of India announced that with effect from April 1, 2011 all listed and public sector entities should converge their reporting systems with IFRS. Because of this requirement Banks should start working on this right now. Major areas likely to be impacted because of this convergence are

- Business combinations
- Financial instruments
- Group accounts
- Fixed assets and investments in property
- Presentation of financial statements
- Share based payments

Experts feel that because of the convergence which is aimed for a uniform method of reporting globally, method of calculating certain financial ratios will undergo change, profitability will be effected. Banks are hence required to study their risk management systems and other procedures to face the impending challenges. In the case of our banking the significant impact will be related to

1. Financial instruments and derivative accounting,
2. loan loss provisioning,
3. accounting for fee income and also accounting for ESOP

1. In the case of **financial instrument accounting** the major difference between Indian GAAP and IFRS pertain to investments, convertible debt and preference shares and derivative instruments. While under Indian GAAP, investments are treated differently based on their classification into held to maturity, available for sale and available for trade, they are all mostly required to be treated under IFRS as available for sale and should be carried at fair value. This fair value is an exit price which is an estimate of its future value depending upon market interactions and hence needing expert's opinion.

Convertible debt is required to be apportioned into equity and financial liability. This bifurcation involves another problem related to the accounting treatment of income from such an investment. The non convertible portion is required to be booked using the fair value concept discussed above and equity portion taken directly to equity. This is in contrast with the present system where the entire amount is treated as debt.

Redeemable preference share is required to be treated as a financial liability and dividend is treated as an interest expense. This naturally will impact the P& L account.

In case of derivative instruments, the problem is more serious as all such instruments are required to be recognised at fair value on the balance sheet. Banks will have to consider such transactions of their clients and their impact. Further with all such derivatives to be booked at fair value will have considerable impact on banks' balance sheets and also their Capital adequacy ratio.

2. With respect to loan loss provisions, the implications will be heavier. Under fair value method of accounting, impact of anticipated loan losses are to be significantly brought to the balance sheet using their prudence to ascertain the risk

associated with each loan and provide for where default is anticipated. While there is no judgemental action is needed under present conditions, with the implementation of IFRS, banks will be required to judge and anticipate the loan delinquencies and provide for losses.

3. Under current rules of Indian GAAP, ESOPs are recognised using either intrinsic value method or fair value method. Under IFRS this choice will not be available and such options are required to be valued at fair value method using some option pricing formula. This would usually result in recognition of compensation cost even if the options are " in the money" on the day of granting them. Further after 1.4.2011, companies have to account for the compensation costs of already issued options.

Banks have to initiate action by themselves on the following aspects if not already done while RBI and GOI have to give needed guidelines and road map for a smooth and successful transition.

- Form a core group for the identifying key areas of impact
- Discuss the issues at all the different levels in the bank
- Impart necessary training
- Rework on the risk management practices, systems and procedures and train the concerned staff on the new methods
- Educate all the stakeholders regarding the impact and bank's position in the market

Learning points: As on date this is more as information to the candidates.

1. Understanding the impending changes in accounting standards and their impact on valuation of assets specially loan loss provisions
2. Need to create the enabling environment in individual banks