

Co-operative Bank Conclave

Treasury & Investment Function

Nagpur

Organised by
Nagpur Branch of WIRC of ICAI

Dhananjay J. Gokhale

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Reference Material

Important documents

- Investment Policy of the Bank
- Master Direction dated April 01, 2023
- Subsequent Circulars & Monetary Policy issued by Reserve Bank of India

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INVESTMENT POLICY

- RBI defined minimum inclusions
- Never super-rides RBI Circulars
- Can be stringent than RBI Circulars
- Define authority matrix
- Stop Loss / Take Profit Limits
- Annual Review
- Must be approved by Board of Directors

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Minimum Inclusions in Investment Policy

- Securities in which investments can be made
- Authority to put in deals
- Procedure for obtaining sanction of appropriate authority
- Prudential limits – quantity (ceiling) and quality of each type of security
- Internal Control Mechanism
- Accounting Standards

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Minimum Inclusions in Investment Policy

- Audit, Review, Dealing through brokers
- System of management of various risks
- Guidelines for valuation & reporting systems
- Stop-loss limits for holding / divesting

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Minimum Inclusions in Investment Policy

- Non-SLR:
 - Nature
 - Limits
 - Risk parameters analysis
 - Entry level minimum rating / industry-wise / maturity-wise / duration-wise
 - Mitigation of adverse impact on concentration / liquidity risk

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Precautions to be taken

- Investments only in own name
- PMS not permitted for own as well as customers
- Credit risk analysis at par with loan proposal
- Reference to defaulters list maintained by CIC (Credit Information Companies)
- Review to be stringent than borrowers

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Precautions to be taken

- Robust internal credit rating system with Quarterly / half-yearly tracking of financial position of issuer with monitoring of credit rating
- Investments to be held only in demat form
- Oversold position / short sale permitted only to eligible entities / securities

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TYPES OF INVESTMENTS

HTM – Held To Maturity

AFS – Available For Sale

HFT – Held For Trading

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TYPES OF INVESTMENTS

Balance Sheet Disclosure

a) Money at Call and Short Notice

b) Investments

a) Government Securities (FV/MV)

b) Other Trustee Securities

c) Shares in Co-operative

d) Others

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HTM – Held To Maturity

Should be within 25% ceiling except that:

1. Excess consists of only SLR securities or TLRO (Targeted Long-Term Repo Operations) of RBI
2. Total SLR in HTM upto 25 % of NDTL as on last Friday of second preceding fortnight

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HTM – Held To Maturity Accounting

- Restriction on sale of HTM
- Profit would be first accounted in Profit & Loss Account and then appropriated to Capital Reserve Account (net of taxes)
- Loss would be accounted in P & L Account

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HFT – Held For Trading

Are those investments which bank expects to make a gain by movement of interest rates / market rates and are required to be sold within 90 days

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AFS – Available For Sale

Are those investments which neither HTM or HFT

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HFT / AFS

Accounting

Profit / Loss would be accounted in Profit & Loss Account

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Shifting of category - HFT / AFS / HTM

HTM to AFS / HFT

- Approval of Board required
- Normally be allowed only at the beginning of the year
- No further shifting to/from allowed
- Disclosure required as per RBI Master Direction

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Shifting of category - HFT / AFS / HTM

HTM to / from AFS / HFT

Accounting

- Transferred at Book Value (which would be net of amortisation)
- Immediately marked to market and provision for depreciation made on the same day
- Thus, Book Value remains unchanged

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Shifting of category - HFT / AFS / HTM

AFS / HFT to HTM

Accounting

- Transferred at Book Value or Market Value which ever is lower (provision for depreciation would be used in case Market Value being lower than Book Value)

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Shifting of category - HFT / AFS / HTM

AFS to HFT

- Approval of Board required
- In case of exigencies, CEO can also approve the same which should be later on ratified

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Shifting of category - HFT / AFS / HTM

HFT to AFS

- Generally not permitted
- Permitted only in exception circumstances
- Approval of Board / Investment Committee required

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Shifting of category - HFT / AFS / HTM

AFS to / from HFT Accounting

- Transferred at Acquisition Cost or Book Value or Market Value which ever is lower (provision for depreciation would be used in case Market Value being lower than Book Value)
- Book Value remains unchanged

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Valuation of Investments

- Concept of accounting of investments and its ramification on valuation / amoritsation
 - FIFO
 - Weighted Average
 - ~~Pick and Choose Method / Random Marking Method~~

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Valuation of Investments - HTM

- Are NOT marked to market
- Premium in Book Value over face value to be amortised over the residual period

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Valuation of Investments - AFS

- Marked to market at least at quarterly intervals
 - I. Scrip-wise Valuation
 - II. Classification (G-Sec / Other approved securities / Shares / Corporate Bonds / Others) wise aggregation
 - III. Ignore Appreciation and provide Depreciation

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Valuation of Investments - HFT

- Same as AFS except that needs to be marked to market at least at monthly intervals

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VALUATION OF SECURITIES

Basic Concepts

Yield = Coupon Rate

(+) Discount

(-) Premium

(+) Risk Spread

Inter-relation between

Coupon Rate / YTM / Maturity Period /
Price

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VALUATION OF SECURITIES

1. Central Government Securities
2. State Government Securities
3. Special Securities issued by Govt like Oil Bonds / Fertilizer Bonds
4. Unquoted non-SLR Securities
5. Treasury Bills (T-Bills)
6. Commercial Papers
7. Units of MFs
8. Shares of Co-operative Institution (if dividend not received to be valued at Re. 1 per Institution)

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Valuation : General Norms

1. Market value of quoted securities – As declared by FBIL (Financial Benchmarks India Pvt. Ltd.)
2. Securities wherein prices not published by FBIL –
 1. Exchange
 2. Reporting platform
 3. Trading platforms
 4. Prices declared by FIMMDA (Fixed Income Money Market & Derivatives Association of India)

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Valuation – Govt Securities

Central Government Securities

1. Quoted: Last traded price in last fortnight
2. Unquoted: Price / YTM by FBIL

State Government Securities

1. Price / YTM by FBIL

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Valuation – Securities

Other Approved Securities

1. YTM mark up by 25 basis above Central Govt securities YTM

Corporate Bonds

1. YTM basis over Central G-Sec as put up by FBIL/FIMMDA
2. At least 50 basis point mark-up
3. Unrated securities – mark up not less than rated

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Valuation – Securities

Example of unquoted Non-SLR Valuation

Rate of interest (Coupon): 9%

Date of Valuation: 31.03.20X1

Date of Maturity: 31.03.20X4

Residual Maturity: 3 Years / Rating: AA+

Par Yield Curve for 3 years: 6%

Risk spread for AA+ rating and 3 years: 2%

Expected market Returns (Yield): $6 + 2 = 8\%$

Valuation as on 31.03.20X1: Rs. 102.58

PRICE(settlement date, maturity date, rate, yield, redemption, frequency, [basis]) {Basis: 3 = Actual/365}

Price(31/03/20X1,31/03/20X4,9%,8%,1,3)

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Valuation – Securities

Special Securities (Oil / Fertilizer Bonds) issued by GoI

1. YTM mark up by 25 basis above Central Govt securities YTM

Units of MF

1. Unquoted: Latest repurchase price
2. NAV
3. Otherwise at cost

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Valuation – Securities

Commercial Paper / Certificate of Deposit

1. Carrying Cost

Zero Coupon Bonds (ZCBs)

1. Compare carrying cost with market value (MV)

2. If MV unavailable, calculate PV

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Valuation – Securities

Example of ZCB Valuation

Date of acquisition: 01.04.20X0

Date of Maturity: 31.03.20X3 (Tenor: 3 Years)

Cost: 85 / FV: 100 / Simple accretion: 5 p.a.

Valuation as on 31.03.20X2

ZCYC Curve plus spread: 6% (for 1 year)

Book Value= $85 + 5 + 5 = 95$

PV of FV 100 with DF of 6% = 94.34

Depreciation = $95 - 94.34 = 0.66$

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Valuation – Securities

Security Receipts (SRs)

1. Refer Para 75 to 79 of RBI (Transfer of Loan Exposures) Directions, 2021

Shares of Co-operatives

1. Regularly dividend paid, then at face value otherwise 100% provision
2. If FS unavailable for more than 18 months, value at Re. 1 per entity

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Valuation – Securities

Equity Warrants arising out of PMCBL amalgamation with Unity SFB Ltd.

1. Equity warrants valued at Re. 1 per warrant

PNCPS arising out of PMCBL amalgamation with Unity SFB Ltd.

1. To be provided 100% by Mar'24

Total provision would be 80% of gross exposure out of which 60% is made till Mar'22 and balance to be made @ 10% each in Mar'23 & Mar'24

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Transactions in Treasury

1. Platforms available
 - i. NDS OM
 - ii. Gilt / demat account opened with NDS member (can use web-access NDS-OM module through Primary Member)
2. Settlement date accounting

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Transactions in Treasury

Short sale in G-Sec – Eligibility

1. NDS OM membership
2. Net worth of Rs. 25 crores
3. Applicable minimum CRAR
4. Net NPA not more than 3%
5. Sound risk management practices
6. Concurrent audit of treasury operations

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Transactions in Treasury

SDF (Standing Deposit Facility) –
Overnight Lending under LAF (without
underlying collateral by RBI)

MSF (Marginal Standing Facility) –
Liquidity window by RBI

LAF – Repo / Reverse Repo

Market – Repo / Reverse Repo

Repo: Borrowing of Money

Reverse Repo: Borrowing of Securities

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Transactions in Treasury

STRIPS (Separate Trading of Registered
Interest and Principal Securities)

Non-SLR Securities

- i. A or higher rated Bonds
- ii. ZCB (issuer to build sinking fund)
- iii. A2 or higher rated CPs / CDs
- iv. Units of MFs (Debt and Money Market)
- v. Equity shares of Market Infrastructure
Companies (MICs like SWIFT)

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Transactions in Treasury

Non-SLR Securities

- vi. Equity shares of Umbrella Organisation
- vii. SRs / Pass-Through Certificates (PTCs)
- viii. Equity shares of DCCB / State CCB

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Transactions in Treasury

Non-SLR Securities - prohibited

- i. Perpetual debt instruments
- ii. Units of MF other than debt / Money Market
- iii. Instruments with original maturity of less than one year
- iv. Shares of bodies / organization unless permitted by RBI

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Transactions in Treasury

Permitted Counterparties (Non-SLRs)

- i. Scheduled Commercial Banks
- ii. Primary Dealers (PDs)
- iii. Mutual Funds
- iv. Pension / provident Fund
- v. Insurance Companies

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Transactions in Treasury

Non-SLR – Prudential Limits

- i. Subject to prudential Exposure caps
- ii. 10% of last March deposit size
- iii. Investment in unlisted – 10% of total Non-SLR of last March
- iv. Exceeding of limit permitted:
 - i. Market Infrastructure Companies (MICs)
 - ii. Umbrella Organisation (UO) of UCB sector
 - iii. Shares of Co-op. Societies as permitted u/s. 19 of BR Act, read with section 56
 - iv. SRs / PTCs
 - v. PNCPS / Equity Warrants of Unity SFB

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Transactions in Treasury

- Repo in Corporate Bonds
- Transactions in CPs / CDs
- Trading and settlement in Corporate Bonds

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Role of Board of Directors

- Review of Non-SLR investments at quarterly intervals
 - Total business (investments / disinvestments during quarter)
 - Compliance with prudential limits by Board
 - Compliance with prudential limits by RBI
 - Rating Migration resulting in diminution of portfolio quality
 - Extent on NPIs and sufficiency of provision

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Placement / Acceptance of Deposits

- Prudential limits for placement of deposits
 - Interbank exposure: 20% of last March deposits
 - Single Bank: 5% of last March deposits
- Prudential limits for acceptance of deposits
 - Interbank deposits: 10% of last March deposits

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Acceptance of Deposits

- Eligibility for UCBs to accept deposits from UCBs
 - Applicable CRAR + 1%
 - Gross NPAs less than 7%
 - Net NPAs upto 3%
 - No net loss incurred in last year
 - Net Profit in three out of four last years
 - No default in CRR / SLR in last FY
 - Sound internal control system with at least two professional directors
 - CBS fully implemented

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Acceptance of Deposits

- What to do if now UCB is not eligible to accept deposits from other UCBs:
 - Phase out 10% by March-end
 - Phase out 40%, 70% and 100% by next three years
 - No new deposits to be accepted
 - Renewals permitted provided phase-out plan is complied
 - If in between UCBs achieves eligibility, no further phase-out plan to be implemented

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Interbank Exposure for UCBs under AID

- Provision @ 20% each year for five years
- Exposure to be considered as NPI
- If difficulties faced in withdrawal of deposits from weak DCCB / State CCB, provision @ 10% each year
- Interest to be recognized on cash basis

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Interbank Exposure

- Board to formulate policy
- Board to take review on half-yearly basis

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Infrastructure of Treasury Department

- Front Office consisting of dealers
- Back Office
- Accounts Department
- Clear-cut functional separation between **T**rading, **S**ettlement / monitoring / control and **A**ccounting

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IMPORATANT ASPECTS

- Deal Ticket
 - Concept of Time Stamp
 - Typical break-up between interest and principal (residual amount)
 - Category of investment
 - Alterations not permitted
- Preparation of Deal Slips which should be serially numbered
 - Settlement Date Accounting

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IMPORATANT ASPECTS

- Reconciliation of Investments on monthly intervals
- Adherence to FIMMDA code of conduct while executing trades on NDS-OM / OTC
- Formulation of internal control guidelines for acquisition of Non-SLRs in secondary market
- Engagement of Brokers

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Audit and Review

- Subjected to Concurrent Audit and report to be placed before CEO / MD at monthly intervals
- Results of internal audit placed before Board on quarterly basis
- RBI Reporting of investments held at last reporting Friday of every quarter
- Internal audit to cover transactions on an on-going basis
- Monthly reconciliation by internal auditors to be placed before ACB

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Board of Directors

- Half yearly review within two months
- Review to be forwarded to RBI by 15th June / 15th December
- Active role in operations is not expected

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OTHER IMPORATANT ASPECTS

- CRR – 4.50%
- SLR – 18%
- Non-SLR

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OTHER IMPORATANT ASPECTS

- CRR
 - Balance with Reserve Bank of India
- SLR
 - Surplus CRR
 - Cash
 - Gold (at price not exceeding MV)
 - Net balance with PSBs
 - Approved securities (Government Securities, Treasury Bills, SLR Bonds)
 - Reserve Fund securities eligible too
 - Reduce encumbered portion

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Investment Fluctuation Reserve (IFR)

1. Create IFR if surplus IDR is reversed
2. to be built up out of realised gains of securities
3. Subject to availability of net profit
4. Should be minimum of 5% of HFT and AFS Investment Portfolio
5. Higher IFR permitted
6. Is considered as appropriation after Statutory Reserves
7. Eligible for Tier II

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Investment Fluctuation Reserve (IFR)

1. Transfer back from IFR to meet requirement for depreciation requirement would be below the line item
2. Distinction between IDR and IFR (above the line and below the line)

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NPI Norms

1. Interest / Installments due for more than 90 days
2. Advances and Investments – Both are classified in same category
3. State / Central Government Guaranteed Investments – similar to Advances
4. Shares of Co-operative

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Income Recognition

- Should be done on accrual basis except for income from units of MFs wherein cash basis is to be strictly followed.
- Concept of Yield
- Concept of 360 days / 365 days
- Money Market Instruments – 365 days
- G-Sec – 360 days
- Due date Diary

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CERTIFICATION REQUIREMENTS & ROLE OF AUDITOR

- Quarterly certification by Concurrent Auditors of physical verification of securities on last reporting Friday
- Monthly Concurrent Audit reports to be placed before CEO
- Statutory Auditors to certify correctness of computation of DTL / NDTL and compliance of CRR / SLR

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CRR / SLR

CRR - Cash Reserve Ratio - 4.50%
(Daily to the extent of 90%)

SLR - Statutory Liquid Ratio - 18%

DTL - Demand and Time Liabilities

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CONCEPT OF DTL

- Demand Liabilities
 - Current Deposits
 - Demand portion of Saving Bank A/C
 - Margins held against BG / LC
 - Matured Fixed Deposits (MFD)
 - DD / PO / MTs / TTs Payable
 - Adverse Balance in Advances A/C
 - Unclaimed Deposits

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CONCEPT OF DTL

- Time Liabilities

Liabilities of the bank which are payable otherwise than on demand like FDRs, RDs, Time liability portion of Saving Bank A/Cs, Staff security Deposits, etc.

Apportionment of SB Account Balance

For each SB A/C >> Calculate monthly min. Bal.

>> Take average of 6 balances = Time Liability (T)

Avg. GL level balance for 6 months minus Time Liability = Demand Liability (D)

Ratio of T : D to be applied

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CONCEPT OF DTL

- Other Demand and Time Liabilities (ODTL) includes –
 - interest accrued on deposits
 - bills payable
 - unpaid dividend, suspense account
 - Borrowings through Upper Tier 2 / Tier 2 Capital
 - Net credit balance in Branch Adjustment account except for credit entries outstanding for more than 5 years (i.e., blocked accounts)

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CONCEPT OF DTL

- Other Demand and Time Liabilities (ODTL) includes –
 - Net Liability towards banking system in India
 - Netting off of liability against assets is permitted with respect to only banking system in India and not with respect to banking system outside India, thus, adverse NOSTRO Balances

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DTL Calculation - Exclusions

1. Paid up Capital incl. Tier 1 & Tier 2
2. Reserves and Surplus
3. Loan taken from RBI
4. Refinance from Exim Bank, NHB, NABARD, SIDBI
5. Funds borrowed under G-Sec Repo
6. ECGC / Insurance claims received
7. Amounts received from court receiver
8. Net income tax provision*
9. Income flows received in advances which are non-refundable
10. Subsidy received kept in zero % FDR / Subsidy Reserve Fund A/C in name of SHG
11. Adhoc provisions made without underlying liab.

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RBI Returns – CRR / SLR

CRR Maintenance reporting to RBI

Form No.	Applicability
A	SCBs including RRBs Small Finance Banks Payment Banks Local Area Banks
B	Scheduled Co-operative Banks
I	Non-scheduled Co-operative Banks

Fortnightly return specifying the bank's position of NDTL within 7 days provisional / within 20 days final

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RBI Returns – CRR / SLR

SLR Maintenance reporting to RBI

Form No.	Applicability
VIII	SCBs including RRBs Small Finance Banks Payment Banks Local Area Banks
I	Co-operative Banks

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QUESTIONS ???

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Thank you !!!

CA Dhananjay J. Gokhale

Email: dhan_gokhale@hotmail.com

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“The attitude of disrespect that many executives have today for accurate reporting is a business disgrace. And auditors ... have done little on the positive side. Though auditors should regard the investing public as their client, they tend to kowtow instead to the managers who choose them and dole out their pay.”

-Warren Buffett

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