CHAPTER 1

RBI Master Directions, 2023- Transition impact

This article aims to:

- Briefly explain the Master Directions, 2023
- Highlight the transition impact (due to Master Directions, 2023) disclosed by 21 banks, which are part of the top 200 companies by market capitalisation as of 31 March 2024.

Background

Until 31 March 2024, Banks[1] were following the Master Direction - Classification, Valuation and Operation of Investment Portfolio of Commercial Banks (Directions), 2021 (2021 Master Directions) for the classification and valuation of their investment portfolio.

There have been significant developments in the global prudential framework, accounting standards as well as in the financial markets-both domestic and global in the last two decades. The Reserve Bank of India (RBI) felt the need for a comprehensive review of these guidelines to bridge the gap with global standards and practices.

Therefore, on 12 September 2023, RBI issued revised regulatory guidelines on investment classification and valuation - the Master Directions – Classification, Valuation and Operations of Investment Portfolio of Commercial Banks (Directions), 2023 (RBI Master Directions, 2023). The RBI Master Directions, 2023 are applicable to banks effective 1 April 2024.

1. Banks include all Commercial banks, public and private (excluding RRBs)
2. Refer First Notes issued by KPMG in India on 4 October 2023 for detailed evaluation on RBI Master Directions, 2023

Key requirements to the RBI Master Directions, 2023[2]

The key changes in the revised directions mainly relate to the following matters pertaining to investments made by banks:

1. **Investment classification:** Banks to classify the investments (except investments in subsidiaries, associate, and joint ventures) into three main categories: Held to Maturity (HTM), Available for Sale (AFS), and Fair Value Through Profit and Loss (FVTPL). All Investments in own subsidiaries, joint ventures and associates would be held in a distinct category, other than HTM, AFS and FVTPL. The RBI Master Directions, 2023 explain in detail the basis of classification of investments. Further, the Master Directions, 2023 do not place any limit on the monetary value of investments that can be made under the HTM category and do not stipulate a period within which investments in that category need to be sold for FVTPL and HTM investments (unlike in the case of 2021 Master Directions).
2. **Reclassification of investments:** Reclassification of investments can take place only in exceptional circumstances, and such reclassification would require Board's and RBI's approval. The said reclassification would be applied prospectively from the reclassification date.
3. **Valuation:** To increase the consistency and comparability in fair value measurements and related disclosures, the RBI Master Directions, 2023 have prescribed that the investment portfolio to be bifurcated into three fair value hierarchies- Level 1, Level 2, and Level 3. Disclosures pertaining to fair valuation have also been prescribed.
4. **Initial and subsequent measurement:** All investments are initially measured at fair value. It shall be presumed that the acquisition cost is the fair value, unless facts and circumstances suggest that the fair value is materially different from the acquisition cost.

   For subsequent measurement, HTM securities are carried at cost without fair value adjustments after initial recognition, while AFS and FVTPL securities are fair valued quarterly or more frequently (securities that are classified under the HFT sub-category within FVTPL should be fair valued on a daily basis). All investments in subsidiaries, associates and joint ventures should be held at acquisition cost. The valuation gain and losses held under AFS shall be debited/credited to AFS Reserve and under FVTPL shall be debited/credited to profit and loss account.
5. **Investment Reserve Account (IRA):** The balance in IRA, if any, as on 31 March 2024, is required to be transferred to the revenue/general reserve, provided a bank meets the minimum regulatory requirements of Investment Fluctuation Reserve (IFR). If a bank does not meet the minimum IFR requirements, the balance in IRA is required to be transferred to IFR. Banks will continue to maintain IFR.
6. **Transition adjustment:** The RBI Master Directions, 2023 have prescribed the following accounting treatment on transition on 1 April 2024:
   - Reclassification of investment portfolio: The investment portfolio as at 31 March 2024 would be reclassified as per the revised requirements.
   - Provision for depreciation: The balance in the provision for depreciation of investments as at 31 March 2024 would be transferred to the Revenue/General Reserve.
   - IRA: The balance in IRA as at 31 March 2024 should be transferred to the Revenue/General Reserve or to IFR, depending on whether the bank meets the minimum IFR requirements.
   - Disclosure requirements: Appropriate disclosures of transitional adjustments to be provided in the notes to the financial statements for the year ending 31 March 2025.

1. Banks include all Commercial banks, public and private (excluding RRBs)
2. Refer First Notes issued by KPMG on 4 October 2023 for detailed evaluation on RBI Master Directions, 2023

Basis of our analysis

Banks have recently published their financial results for the quarter ended 30 June 2024, including notes on the impact of the transition requirements of the RBI Master Directions, 2023. In this article, we have captured the transition impact disclosed by 21 banks, which are part of the top 200 companies by market capitalisation as of 31 March 2024. We have compiled these disclosures to highlight the impact of the transition on their financial information.

Our analysis involved reviewing standalone financial results published by these banks. We have compiled the transition impacts as per the RBI Master Directions, 2023.

Table 1

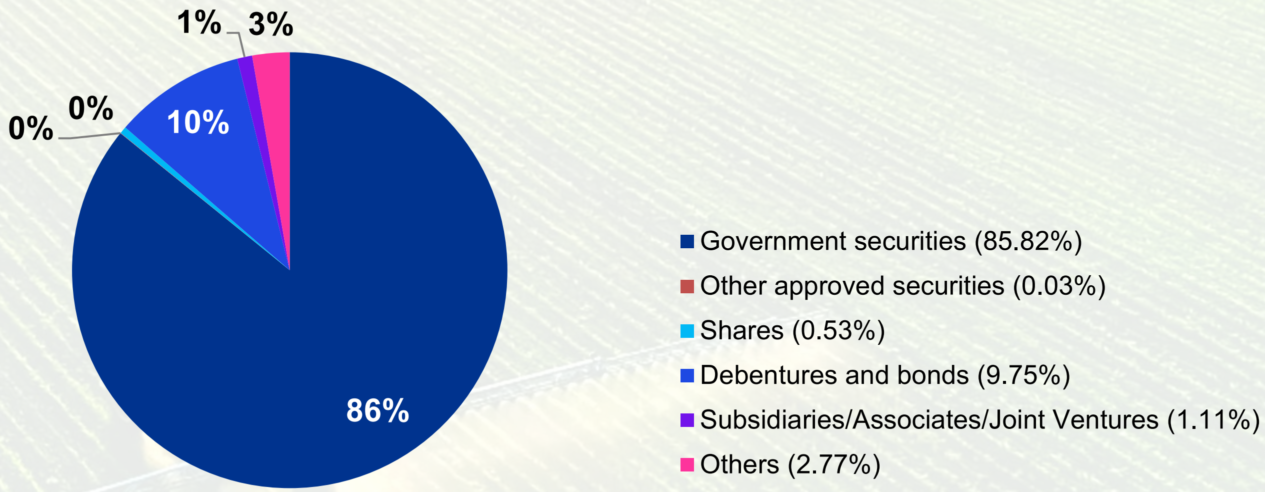
Sector categorisation used in the population	Number of banks	Sector categorisation used in the population
Public sector	11	Public sector
Private sector	10	Private sector

Table 1 shows that out of the 21 banks, 11 are public sector banks and 10 are private sector banks.

Source: KPMG in India's analysis August 2024 based on financial results of banks (part of top 200 listed companies) for the quarter ended 30 June 2024

The below graph shows the composition of investments held by these 21 banks as at 31 March 2024. This graph depicts that banks have significant investments in Government Securities, followed by Debentures and Bonds, and others.

Investment composition



Source: KPMG in India's analysis August 2024 based on financial results of banks (part of top 200 listed companies) for the quarter ended 30 June 2024

Analysis of standalone financial results

Annual disclosures: The RBI Master Directions, 2023 have prescribed that banks provide robust disclosures regarding their investment portfolio. Most of these disclosures are required in the financial statements for the year ending 31 March 2025.

Quarterly disclosures: Though there is no specific disclosure requirement prescribed for the quarterly financial results, in the financial results of these 21 banks for the quarter ended 30 June 2024, certain banks have provided the disclosure explaining the application on RBI Master Directions, 2023 along with transition impact of the same on reserves and surplus.

Table 2 below provides a summary of banks that have included a note regarding the application of RBI Master Directions, 2023 in their financial results and have also disclosed the impact of transition adjustment as on 1 April 2024.

Table 2

<table>
<tr><th>Sector</th><th>Note on application of RBI Master Directions, 2023</th><th>Disclosure of Transition adjustment</th><th>Impact for the quarter disclosed</th><th>Total</th></tr>
<tr><td rowspan="3">Public</td><td>No</td><td>No</td><td>No</td><td>1</td></tr>
<tr><td rowspan="2">Yes</td><td rowspan="2">Yes</td><td>No</td><td>4</td></tr>
<tr><td>Yes</td><td>6</td></tr>
<tr><td rowspan="2">Private</td><td rowspan="2">Yes</td><td rowspan="2">Yes</td><td>No</td><td>7</td></tr>
<tr><td>Yes</td><td>3</td></tr>
<tr><td colspan="4">Total number of banks covered</td><td>21</td></tr>
</table>

Source: KPMG in India's analysis August 2024 based on financial results of banks (part of top 200 listed companies) for the quarter ended 30 June 2024

Out of 21 banks, 10 public sector banks and 10 private sector banks have disclosed the adoption of RBI Master Directions, 2023 and have further disclosed the impact of transition adjustment as at 1 April 2024. Further, 6 public sector banks and 3 private sector banks have also disclosed the quarterly impact of RBI Master Directions, 2023.

Table 3

Banks have disclosed transition impact	Public	Private	Total
Yes	10	10	20
Transition impact as a % of Investment value as on 31 March 2024 (% range in absolute impact)	**Public**	**Private**	**Total**
~0% to 0.5%	4	5	9
~ 0.5% to 1 %	6	4	10
~1% and above	-	1	1

Source: KPMG in India's analysis August 2024 based on financial results of banks (part of top 200 listed companies) for the quarter ended 30 June 2024

Table 3 provides a summary of net transition adjustment impact as a percentage of investment value as of 31 March 2024.

It is noted that in absolute terms, 9 banks have an impact of 0% to 0.5%, 10 banks have an impact of 0.5% to 1% and 1 bank has an impact of more than 1% over investment value as of 31 March 2024.

Looking ahead

On the basis of our analysis, banks have published their first set of quarterly results subsequent to the application of RBI Master Directions, 2023 and have provided the transition impact on 1 April 2024. Further, the RBI Master Directions, 2023 have also prescribed robust disclosure requirements pertaining to the investment portfolio of a bank. Most of these disclosures are required to be provided in the financial statements for the year ending 31 March 2025. Accordingly, banks would need to put in appropriate systems and processes to gather this information.

Some of the key disclosures required to be provided in the notes to accounts in the financial statements include the following:

1. **Carrying amounts and fair value:** Carrying amounts and fair value of each of the categories (i.e., HTM, AFS, FVTPL) and each class (i.e., government securities, other approved securities, shares, debentures and bonds, subsidiaries, associates, and joint ventures).
2. **Gain/loss on investments:** This would require disclosure of gain/loss for each category of investments that has been recognised in the Profit and Loss Account or in the AFS Reserve.
3. **Disclosures as per fair value hierarchy:** For each class of investment, banks would need to disclose the investments that are subsequently measured at AFS and FVTPL and break these amounts up, basis the fair value hierarchy (Effective date is year ending 31 March 2026).
4. **Transition related adjustments:** Detailed disclosure on transition related adjustments.
5. **Details of derivative portfolio:** This requires the disclosure of MTM of the assets and liabilities of the interest rate derivatives, exchange rate derivatives, credit risk derivatives and other derivatives, and their break up in the fair value hierarchy.

3. Insurance companies within the group have continued to follow the investment regulations as prescribed by Insurance Regulator and Development Authority of India (IRDAI)