INVESTMENT DEPRECIATION RESERVE FOR UCBs

1. Investment portfolio maintained by banks is susceptible to market risk, as the market value (price) of securities can decline due to the market factors, such as yield, liquidity, spread, etc.

2. As per the regulatory guidelines, the investment portfolio can be maintained in three categories, namely, Held to Maturity (HTM), Held for Trading (HFT), and Available for Sale (AFS). While HTM is referred to as banking book, the investment held in HFT, and AFS is termed as Trading Book.

3. In accordance with regulatory guidelines, no valuation loss is recognised in the banking book, but the same is to be recognised and accounted for in the trading book.

4. A provision made against valuation loss, known as marked to market loss, by debit to banks' Profit & Loss Account (expenditure head – provisions and contingencies) is termed as Investment Depreciation Reserve (IDR). Though its nomenclature includes the word 'reserve', it is not a reserve and is essentially a provision.

5. Banks should maintain IDR equivalent to the marked to market valuation losses, as at the end of an accounting period. While such valuation should be done at least monthly for the HFT category, the securities included in the AFS category must be valued at least on an annual basis.

6. For valuation, the valuation losses and gains can be netted across the same category and classification. While categories refer to HFT and AFS, the classification for balance-sheet involves five classes, namely, government securities, other approved securities, shares, PSU bonds, and others.

7. The following instance explains the above. Any MTM gains and losses on government securities in the AFS category can be netted but the same cannot be done for the government securities lying across AFS and HFT categories. Similarly, gains and losses cannot be netted between bonds and government securities, even though both may be in the AFS category. IDR should be maintained for the net amount of marked to market losses by ignoring un-netted gains, as explained above.

8. SLR securities may be valued using the prices available on the web site of the Financial Benchmarks India Private Limited (FBIL). Non-SLR securities may be valued using their respective listed market prices or by using the FIMMDA methodology.

9. If case the IDR held by a bank is found to be above the requirement, the same should be reversed by a credit to P&L Account: Expenditure - Prov. & Contingencies. Further, the resultant impact of such reversal on the balance of profit (net of taxes and other statutory transfers) should be appropriated, below the line, to Investment Fluctuation Reserve (IFR).

10. Reversal of excess IDR is necessary to correctly reflect the position of net assets in the balance sheet and also to correctly estimate profit, and the tax liability. Therefore, maintaining an adequate provision against the investment portfolio is an important element for ensuring a true and fair depiction of the financial position of banks in their financial statements.

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