Opinion

TUESDAY, SEPTEMBER 17, 2019

TRUMPING TRIBUTE

Prime Minister of India, Narendra Modi

"The special gesture of President Donald Trump to join us in Houston highlights the strength of the relationship and recognition of the contribution of the Indian community to American society and economy"

Big exports boost requires a bigger change in strategy

Govt does well to fix export schemes and increase credit flows, but big exports-growth needs a whole new approach

THE GOVERNMENT HAS done well to come out with a series of initiatives to boost India's flagging exports; between FY14 and FY19, India's exports grew at less than 1% per annum. The measures, announced last week, include replacing a WTO-non-compliant duty refund scheme with a compliant one and, with a ₹10,000 crore higher outlay, there are measures to ensure a higher amount of export credit—around ₹36,000 crore—is available at lower interest rates. Other measures include ways to reduce the processing time at airports and ports, etc. While a weakening rupee should help India's $330-bn exports grow, it is not clear how much these moves will help boost growth to reasonable levels in even the medium term, much less be able to reach commerce minister Piyush Goyal's $1-trn-stretch target.

Though Goyal was pilloried for his recent slip about Einstein having discovered gravity, he was right when he said that looking at the past didn't necessarily help predict how the future would unfold. Between 1990 and 2018, while India's exports grew just 18 times, for instance, Vietnam's rose 102 times, as a result of which, its exports are 75% those of India today; these were a mere 6% in 1960. In other words, it is not how fast global trade is growing that is critical, what matters is seizing the opportunities that global trade throws up; Vietnam didn't just catch the textiles boom, it also rode the electronics boom, and the possibilities that got thrown up with rising US-China tensions. Seizing the opportunities, however, requires an almost complete retooling of India's manufacturing/regulations since no country can become an export powerhouse unless its local production is globally competitive; cheaper export credit, for instance, is a good thing, but it cannot make an uncompetitive product into a world-beating one. In which case, India needs to fix its infrastructure deficit, high corporate tax rates, high-cost labour and land, and reduce costs associated with bureaucratic red tape, convoluted decision-making, etc.

It is also critical that various sectoral distortions be corrected; so, for instance, India's tax policies in textiles are biased against man-made fibres whereas global demand is for such materials, and not for cotton, which is the mainstay of India's industry. Other sectoral policies also need to be fixed. While India's policies on mobile phones have so far attracted mostly small players, the bulk of the $300bn global export market for smart-phones—60% of this takes place from out of China—is serviced by four of five large companies, like Apple and Samsung; it is difficult to see how India's exports of smart-phones can take off unless India is part of the global value chains of these firms. There is, so far, little serious attempt to ensure that firms like Samsung and Apple shift their production bases to India; the boom in India's automobile exports after Suzuki's entry ensured its entire vendor-base moved to India, though, should have made clear just how important being part of global value chains is. Around 70-75% of global trade, in any case, takes place through value chains run by MNCs across the world. Agriculture is another big area of export potential, but harnessing this requires moving away from today's stop-go policies towards agriculture exports—normally based on how local prices are faring—as well as those like MSPs that distort markets. In the case of minerals, where there is big exports potential, similarly, India needs to both get its royalty-cum-tax regime right as well ensure all permissions—including licensing fresh mines and all environmental clearances—are given at the earliest. Only a policy that aims at making a country more competitive can deliver top-class exports growth; an exports-policy makes little sense on its own.

Not ambitious enough

Housing package needed to have been a lot bolder

THE LAST MILE funding for stalled housing projects will not solve the real problem in the real estate sector, but will nonetheless help. The ₹20,000 crore fund, to be set up on the lines of the National Infrastructure and Investment Fund (NIIF), will be used to complete affordable and mid-category housing projects. The government's contribution would be ₹10,000 crore, with sovereign investors, and the likes of an LIC, expected to bring in the rest.

The reason why the financial assistance may not help resuscitate much of the sector is that most housing projects, today, are stressed. The scheme, however, is only meant for those projects that have not been admitted to the NCLT for a resolution process, and those where the loan exposure hasn't gone bad. Moreover, construction should have hit 60%, which is probably not the case for the majority of projects. The point is that, if the project is net worth positive, and 60% of it is complete, the promoters should not have trouble borrowing anyway. It is the promoters with weaker balance sheets, those unable to access conventional sources of funding, who need help.

While it is hard to estimate how far ₹20,000 crore can go, Kotak Institutional Equities (KIE) points out there are currently 4.1 lakh apartment units costing less than ₹45 lakh. It is not clear how many of these have progressed to the extent of 60%, but KIE believes ₹20,000 crore should be enough to fund 40% of the construction costs for about 2.5 lakh units.

To be sure, the government doesn't want to be bailing out every errant builder. Neither does it want to be trapped in litigation. Also, it is understandably more concerned about affordable homes—costing below ₹45 lakh—and mid-income housing rather than luxury apartments. Nonetheless, given how a revival in the real estate sector—especially housing—can make a big difference to the economy, the government could have looked at a much bigger level of financial support, and also enlarged the scope of the fund. For instance, it could have included some stressed projects, which have not made it to the NCLT, but where the loans may have gone bad, by working with the banks to rope in a new promoter. The NCLT process, unfortunately, is time-consuming, and the assets end up being sold to buyers, with banks taking massive haircuts. Intervening before a company is admitted to the NCLT will help projects fetch their right value, and banks, too, would recover more in quicker time. A bigger fund—at least ₹40,000 crore—with a larger contribution from the government is needed, and the conditions need to be relaxed. The returns from this investment can be very high.

Rash-driving PREMIUM

Linking vehicular insurance premiums to driving behaviour is a good idea

A DIPSTICK MEASURE of how seriously the government is taking the issue of road accidents and poor driving behaviour—apart from the heavy fines under the amended Motor Vehicles Act—is the fact that it is mulling over linking premiums for vehicular insurance to the individual's history of traffic violations. Indeed, the compounded penalty could induce motorists to exhibit safer driving behaviour. On September 6, IRDAI notified the constitution of a working group to recommend the implementation framework and methodology for a potential premium-driving behaviour regime. The national capital territory (NCT) might see a pilot launch of the new insurance policy as early as November.

At present, premiums for automobile insurance in India are dependent on the make and model, as opposed to the global practice of basing them on the driving practices of the insurance beneficiary. However, the new system is expected to follow the globally-accepted points-based model, wherein the severity of traffic violations affects the premium. Failure to wear a seatbelt, since it doesn't expose the vehicle to risk of accident, would lead to a much smaller rise in insurance premium as compared to, say, having a history of drunk driving. The data for customising insurance premiums is expected to be sourced from Automated Traffic Enforcement systems and *e-challans*. This model would, equally, give discounts on premiums to motorists with exemplary records of driving behaviour. For better collation of data, perhaps the use telematics devices, or black boxes, within vehicles could be considered. This system of pay-the-way-you-drive insurance—based on technology that records information like vehicle speed, location, driving frequency, and other performance indicators like how hard the brakes are applied, how rapid the acceleration level is, and how sharp of a corner is taken—has taken off in developed nations. India must take that route, too.

HIT RATE

THE CRITICAL PART OF LINKING THE DEPOSIT RATE TO THE EXTERNAL BENCHMARK HAS TO BE CONSIDERED, AS THIS ONE-SIDED-LINKAGE CREATES CHALLENGES ON INTEREST SPREADS

The external benchmark conundrum

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Views are personal

THE PRICE OF any commodity should ideally be determined in the market. However, often, there is a preconceived notion of how prices should behave. We want stock prices to go up, commodity prices to come down, exchange rate to be steady, and interest rates to come down. These preconceived notions can, then, have a bearing on actual price if there is regulatory power. Let us see how this works.

When it comes to, say, commodity prices, there is the eternal conundrum of whether the farmer should get a higher price, or the consumer should pay a lower price. Today, while the MPC is happy that inflation is down, the income of farmers has been affected, which has affected spending. The reverse of the two can cause political upheaval. But, there is no control over prices as there are myriad players. The same holds for currency. RBI can intervene in the market, and augment supplies to stabilise the rupee, or, conversely, withdraw dollars to ensure there is no further appreciation. But, being a market-determined rate, RBI cannot force the price in any direction by notification, which was the case in the pre-1992 days.

However, when it comes to cost of capital, there has been constant lament that interest rate transmission is not happening, and while the interest rate is no longer controlled (remember the MLR), the options tried were PLR, base rate, and the multiple MCLR system, where the latter two were formula-driven. With the market not quite being amenable, the mandatory link with a benchmark is the final regulatory push that compels banks to fall in line. Curiously, when it comes to interest rates, just like, say, a farm product, there are two sides, too—a saver and a borrower. The die has been cast in favour of the borrower, who should pay less on loans if the interest rate comes down. Ideally, the choice should have been with banks whether or not to link with benchmarks, but after quite singularly bringing in a regulatory formal-based base rate and MCLR, the benchmark is the third on the book shelf of the library that will now rule the market.

The central bank, as the monetary authority, seems to be better-placed when it has regulated banks to use the market benchmark route as it makes monetary policy more effective. RBI had been expressing its angst against transmission, especially since 110 bps cut in rates did not make banks budge much. Now, there is no choice once a benchmark has been selected. But, interestingly, after the last cut by 35 bps, the 10-year Gsec, which is market-driven, has actually remained intransigent in the 6.5% range, and not come down. Hence, if banks had linked retail loans to the 10-year Gsec, even the latest dictate would not have helped as the lending rate would have remained unchanged, as the market, which is driven by other factors, has not moved in accordance with this change. Hence, there are limits to which the benchmark would work.

How about the banks? They are probably riding the horns of a dilemma. Which benchmark to use? Which loans to include besides retail and SME? As deposits are presently not linked with the benchmark concept (except for a specific bank, which has linked savings rate), how do they manage their liabilities? Linking assets to the benchmark, and not the liabilities will strain the bank's P&L. But, if the deposit rate is also linked to a benchmark in course of time, then customers would be in a quandary as they go in for bank deposits on the assurance of a fixed known return. Now, if it is also made variable, then they would have to bear the volatility in returns, which was not part of their plan. How about the spread over the benchmark, which also has to be anchored for 3 years?

If banks want to play safe, they have to choose the benchmark that reacts either the most or least to the repo rate change—Tbill or Gsec, depending on their appetite. The rules are not yet open about whether deposits too can be linked to the same benchmark in phase 2, if, at all, there will be one. This cannot be changed and holds for all customers, and, hence, has to be done with careful thought. Next, the spread over the benchmark should be clear. Here, banks will need to work out their costs, and the possible margins that they would like to maintain, just like what was assumed when working out their MCLRs. This would be the basic lending rate, specified as xxx bps over the benchmark. Wild swings in the benchmark can, however, mean volatility in earnings, especially in a regime of declining interest rates.

> **Customers should continue to have a choice of going in for a fixed or floating rate, as it can affect them adversely when the cycle moves up**

How about customers? Intuitively, they would be better off when rates are moving downwards as there would be substantial gains in their EMIs or interest outflows. But, in a rising interest rate scenario, which cannot be ruled out as every economy goes through these phases, there would be challenges in maintaining these outflows. In FY20 so far, the 10-year GSec has moved between 6.45-7.43%, which is almost 100 bps. The 364-day Tbill moved between 5.74%-6.5%, which is almost 75 bps.

An interesting observation here is that when the financial crisis erupted, which was based on large scale defaults on home loans, it was precisely because the interest rate cycle had turned upwards, and pressurised borrowers, which caused them to default, and leave their homes and keys. While such an occurrence has been looked at today as being a black swan incident as it looks very unlikely that there can be thousands of home owners defaulting at the same time, it is a possibility that cannot be ruled out as interest rates on home loans, which is what is being driven by the government, is going to be variable.

The new interest rate setting model, based on benchmarks, will be a new experience. Hopefully, customers should continue to have a choice of going in for a fixed or floating rate, as it can affect them adversely when the cycle moves up, just as they benefit when it comes down. Also, the critical part of linking the deposits to the external benchmark has to be taken as this one-sided-linkage creates challenges on their interest spreads. As retail and SMEs also tend to move in large numbers, when it comes to response to lower interest rates, and the new dispensation comes in the downward movement regime, the response in upward movements would require close monitoring. From the point of view of monetary policy, this will go down as the final salvo being fired.

Federalism & the Finance Commission

The terms of reference of the 15th FC are too expansive, and tilt the fiscal balance further in favour of the Centre over the states

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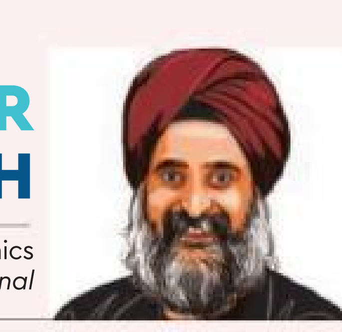

THE CURRENT RULING coalition has shown a propensity for bold moves in its attempt to reshape India's polity and society to match its vision of the nation. The economy has sometimes received similar treatment, with the GST finally being implemented; demonetisation, and public sector bank mergers are two other examples. The last Union Budget was somewhat timid, perhaps, given the growth slowdown, but recent economic policy changes have shown more willingness to respond vigorously to the problem.

Of course, boldness does not guarantee that a decision is the best possible, or even that it is a move in the right direction. The Terms of Reference (ToR) for the 15th Finance Commission (FC XV) reflect that cautionary observation. Finance Commissions have been one of the success stories of India's constitutionally created institutions. Despite shortcomings, they have established precedents, mostly dealt well with challenges and changes in the country's federal finances, and retained some degree of independence and integrity. The central government has not always adopted their recommendations wholeheartedly, but overall, it has respected the institution. The current challenge, however, is whether the ToR will push FC XV into problematic territory.

The main job of the Finance Commissions has been to recommend tax sharing rules between the Centre and the states, and among states, supplemented by other kinds of fiscal transfers. A major goal has been to help poorer states fund adequate levels of public service. The challenge has been to achieve this without unduly damaging state government incentives for raising their own revenue, and for spending with profligacy. Given the large transfers required by the constitutional assignments of tax authority, and India's heterogeneity, the outcomes have not been too bad, certainly better than in some other large federal nations, which have seen sub-national governments spin out of control.

So, what is the problem with the FC XV ToR? I would argue that they are too expansive, and that this expansiveness is in the direction of tilting the fiscal balance further in favour of the Centre. In particular, the call to revisit the previous FC's decision to increase the share of the states is worrying—that decision made a great deal of sense in putting the states on a firmer fiscal footing, while also reducing the scope for discretion, and political wheeling-and-dealing that comes with it. As Govinda Rao had pointed out in 2017, the net increase in the states' share was much smaller than what still gets reported, and going back on what the last FC did will be damaging. The ToR also places emphasis on providing performance incentives to states, and controlling "populism," but that raises all kinds of difficulties in defining that term, and could lead to a complex mess, just when the last FC had succeeded in simplifying, somewhat, the criteria for fiscal transfers. Incentives of this nature had been tried earlier, and did not seem to work particularly well.

Perhaps the most striking example of pushing the envelope of the ToR is the recent, last-minute addition of asking FC XV to suggest ways of allocating non-lapsable funds for defence and internal security. Aside from issues of process, the aspect of concern here is that a technical panel that has already almost completed two years of consultations and analysis is being asked to weigh in on issues of expenditure that have a high level of political sensitivity. It fits in with an approach to the ToR that seems to push FC XV into serving as a political tool of a particular national agenda.

It is certainly possible that the final report, now due at the end of November, will manage to finesse the political difficulties. Certainly, FC XV has extraordinary technical issues to deal with after the introduction of the GST, the elimination of the Planning Commission, and the proposal to change the base year for population weights (which poses its own set of political challenges). But, I would argue that the Centre's ToR have been bold in the wrong direction, towards greater central control. What is needed is a fiscal federal system in which states and local governments (particularly cities and larger towns) have greater autonomy to decide on their own revenues, perhaps by piggy-backing on the central income tax, or by strengthening local property tax systems, or other avenues that will allow sub-national governments to be judged, by their constituents, on whether they are raising these revenues effectively, and translating them into higher quality public services. Centralisation of fiscal authority merely allows sub-national governments to go on contending that the Centre is the source of their problems.

> **What is needed is a fiscal federal system in which states and local governments have greater autonomy to decide on their own revenues**

Increasing the fiscal authority and autonomy of state and local governments will require constitutional changes, but these have been implemented before in the realm of fiscal federalism, and the government has demonstrated its willingness to be bold in other arenas. Given the timing of the FC cycle, perhaps the Centre, through the NITI Aayog, should immediately consider structural reforms in India's fiscal federalism that will promote efficient sub-national spending on health, education and infrastructure, and lay the groundwork for the kind of broad-based growth that India needs.

LETTERS TO THE EDITOR

Aryan migration proved

The paper titled "The Formation of Human Populations in South and Central Asia", published in the highly regarded journal *Science*, has proved the Aryan migration theory conclusively, on the strength of 'genome-wide ancient DNA data from 523 individuals spanning the last 8,000 years'. Hindutva proponents and partisans can no longer defend the 'Out of India' migration theory. It has to be now conceded, without reluctance, that we are 'all migrants and all mixed'. Some came early and some late; those who are regarded as the indigenous people are the descendants of 'Out of Africa' migrants, who reached India around 65,000 years ago, and those known as the Aryans reached India around 2,000 - 1,500 BC, from the Central Asian steppe. The Aryans arrived in India not only with their Indo-European languages and pastoral techniques but also their cultural practices, and introduced a hierarchical social system based on birth. It should be clear, then, that the Vedic culture cannot be equated with India's composite and syncretic culture. The definitive findings published in *Science* should dissuade the Hindu Right from harping too much on *pithrubhoomi* (fatherland) and *punyabhoomi* (holy land). The histories of populations, and the extent of their interbreeding supported by genetic data are not amenable to alteration to suit anyone's political or ideological leanings. The article should open the eyes of those who believe in 'one nation, one religion', 'one nation, one culture', 'one nation, one ideology' and 'one nation, one language' to the beauty and validity of the concept of 'unity in diversity'. Large sections of the media, print and electronic alike have chosen to ignore the significant findings about the provenance of Indians, betraying their elitist bias and vested interest.

— G David Milton, Maruthancode

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PORTRAIT: SHYAM KUMAR PRASAD

PRAKASH JAVADEKAR
Union minister for information & broadcasting

Why Modi is a Level 5 leader

The PM is a communicator par excellence. He speaks directly to the people and creates a bond with them, and gives confidence to them

Level 5 Leadership connotes Honesty and Integrity, Commitment & Passion, Decision Making, Accountability. Over and above, a level 5 leader must be a good communicator, creative and innovative, who delegates and empowers and is an Inspiring leader. On all these criteria, prime minister Narendra Modi stands out.

His honesty and integrity is full & final. For him, national interest is the only interest. This image got widespread acceptability during his stint of 12 years as Gujarat CM. This stood out against the backdrop of policy paralysis, corruption and vaccum of leadership which country experienced during 2004-14. Therefore, people love him. The poorest of the poor is convinced about his honesty and integrity. It is well known that illiterate intelligence is more effective than educated incapacity many times. In five years, there is not a single charge of corruption against his government.

His humane face was visible when he consoled ISRO scientists after last minute snag in Chandrayaan-2. Before leaving Sriharikota, he delivered one of the best motivational speech to the scientist and engineers of ISRO.

After assuming power in 2014, he bowed before the Parliament footsteps, followed by bowing to the Constitution and declared that his government is dedicated to the welfare of the poor, SC/STs, downtrodden and hitherto neglected. He coined a slogan 'sabka saath, sabka vikaas'. This year he added 'sabka vishwas' which explains his intentions very clearly.

He thinks differently and acts differently. To motivate and get full cooperation of bureaucracy, he appointed 10 groups of secretaries to prepare a roadmap for the government in 10 different sectors. All the groups gave presentations, and after due diligence, he asked them to work with speed to achieve their own goals. He asked them to present their progress the year after.

Probably, he is the first prime minister who has written a book to guide and give confidence to the students about how to approach the examination and challenges in life. He titled it as Exam Warriors. Successively for two years, he addressed more than 100 million students and parents. In his interaction with students, he even referred to PUBG, making it clear that he is updated on what is happening around. He establishes immediate connect with the students and youngsters.

> He is creative and innovative. He understands that India lacks in innovation, and only research & innovation will make India a part of the Big League

He was probably the first Indian politician to realise the potential of social media and used it effectively not only to reach out but, establish immediate connect with the youth.

He is a communicator par excellence. He speaks directly to the people and creates a bond, gives confidence to them. People respond to his appeals even if they have to forgo gas subsidy or travel concessions. Through his communication, he motivates.

The decision on GST, demonetisation, Surgical Strike, Balakot Air Strike, action against corruption, Abrogation of Article 370 provisions, law banning Triple Talaq are some examples of decisive leadership.

Also, 10% EBC reservation, Ujwala gas scheme, Pradhanmantri Awas, Ujala giving LED, Mudra, Skill India, Ayushman Bharat, Kisan Sanman, Pension to unorganized labor- small traders- farmers, remunerative prices to farmers, 95 million toilets are examples of empowerment of poorer section.

GST is a living example of his faith in co-operative federalism. Decisions about every word of GST law, rules and rates were decided unanimously though there is a provision of decision by voting. Increase in devolution to the states from 32% of central resources to nearly 49.5% shows his faith in federalism.

He has declared new goals for his second term—$5 trillion economy, assured water supply to every household, providing social security to all needy sections and, above all, 'sabka vishwas'.

He is creative and innovative. He understands that India lacks in innovation, and only research & innovation will make India a part of the Big League. Therefore, he started ATAL Technology Labs in nearly 3,000 schools, where robotics, 3D printing and other advanced material is made available. Students experiment with these modern gadgets and come out with exciting ideas. These are mapped in Olympiad organised for this. For engineering students, he promoted 'Smart India Hackathon', where team of students work on some problem statement and come out with digital/hardware solutions. The final round is organised at 25 centres, in which 10,000 students work non-stop for 36 hours. Every year, he interacts with these students at midnight and inspires them.

He has ensured Atal Incubation Centre's in various IITs/NITs. In this budget, he has come up with the scheme of the National Research Fund. He has sanctioned 'PMs Scholarships' to encourage real advanced research. He interacts regularly with start-ups and meets youths with innovative ideas.

BIT BY BIT

iPhone opportunities, & challenges

NANDAGOPAL RAJAN
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Apple has played some strategic pricing with its new iPhone, but its trump card might be an older phone

THE NEW IPHONES are here. Apple has, this time, chosen to refresh its lineup with upgrades of all the three phones it launched last year. So there is the iPhone 11, which betters the popular iPhone XR, the iPhone 11 Pro to replace the iPhone XS and the iPhone 11 Pro Max, an upgrade on the iPhone XS Max. All three phones are upgrades, so no radical change in design or hardware, except better, and more, cameras as well as a more powerful processor, the A13 Bionic.

Apple will be hoping that the improved cameras on its new phones—the iPhone 11 has two cameras and the iPhone 11 Pro models three lenses—will get at least its dedicated user base to upgrade. With what it has launched this time, it might be difficult to get those using newer models to opt for an upgrade, but it might impress those with models up to the iPhone 7.

Research firm Canalys says that from Q4 2018 to Q2 2019, Apple shipped 87 million of its latest iPhones, 26 million less than what the previous generation (iPhone 8, 8 Plus and X) achieved in the same period the year before. The sale of its older-generation iPhones, meanwhile, grew 12.4%, to 61 million units. This will be the first set of numbers Apple will hope to change with the new phones. It has to somehow get its customers to buy more of the newer phones.

This is why with the iPhone 11, Apple has brought down its price tag significantly. While the iPhone XR was launched at ₹76,900, its successor has a starting price of ₹64,900. It will be hoping that a lot of users in countries like India pick up the new phones instead of opting for older devices. But the fact remains that the iPhone 11 is still an expensive phone for Indians. However, it might have a chance now when users are comparing with other flagships like the Samsung Galaxy S10 or the Note 10. When it comes to specs, all these phones are very similar—with the iPhone offering a lot more in terms of sheer ecosystem advantages.

> Apple's worry for markets other than India is that, for three years now, it has had the same design and incremental updates

But, after the launch of its new phones, at least in India, Apple can expect a significant jump in numbers. That is because its most popular phone has become more affordable. Canalys says the iPhone XR, which was introduced in October 2018, shipped 47 million units till June 2019. That is almost the combined numbers of the other two phones launched at the same time—the iPhone XS and iPhone XS Max. That was because the phone was selling around ₹54,900 after a price cut some months ago and raked in a lot of numbers in India. The iPhone XR can now be purchased for as low as ₹49,900. Ahead of the holiday season in India, that might be a very strategic new price for Apple, one that helps it take away numbers from OnePlus, which lords over the premium segment now. For the average Indian, the iPhone is still an aspirational phone, and given a choice, he would go for it even if it costs a few thousand rupees more.

But, that's just India. Apple's worry for the rest of the world is that, for three years now, it has had the same design and incremental updates. Most of what it has offered now, like the ultra wide lens, has been in the market for a while now. However, its processor is way more superior and so are its efforts at computational photography. But, will that be enough for its captive base of users in countries like the US and Australia to increase their monthly subscription and get a new phone? That, we will have to wait for a few months to see. Of late, these users have been holding on to their phones for longer, thus impacting the numbers for the Cupertino tech firm.

So, even as it could end up with better numbers in India, there will be a worry that its flagship phones won't do as well as it wants them to. But then Apple might be okay lying low for another year till it prepares for its big 5G plunge in 2020 with radically different iPhones.

IND-AS FOR BANKS

Complexity will be the key challenge

It is a bit hard to imagine that the economy would always behave as per our models

ANIL KISHORA
DMD & Chief Risk Officer, State Bank of India. Views are personal

IT IS A MATTER OF time before the new accounting standards, Ind-AS, kick in for banks in India. These originate from an innovation called IFRS 9 or CECL, if you prefer the American version, that effectively puts accounts and risk together in a blender. How will this initiative pan out? There are assessments that point, with some degree of certainty, to elevated volatility in accounts—P&L in particular—as 'fair value' gets to broadly determine what banks report in their annual accounts.

In the aftermath of the 2008 financial crisis, the Basel Committee on Banking Supervision came up with new norms and standards. While Basel III is still under implementation, a more evolved and, in some ways, simplified Basel IV is on the anvil. Rules and regulations continue to originate unabated globally to ensure banks maintain adequate capital, classify their assets appropriately in a timely manner, deliver proper managerial conduct and face enforcement action for breaches or deviations from expected standards. Many would agree that the system is still in shaky equilibrium, with the key stakeholders vying with each other to succeed in finding the right solution to de-risk the system and, of course, the depositors, who are actually the real lenders.

Now, the two premier global accounting standards setting bodies—International Accounting Standards Board (IASB) & Financial Accounting Standards Board (FASB)—have come up with the new mechanism where accounting itself is called upon to capture the risk by adjusting the valuations on the go. Is it set to go down in history as a big game-changing invention in accounting? We don't know yet, but it is clear that accounting would no longer be a routine and mundane discipline that it has remained since Friar Luca discovered, from merchants of Venice, the good old double-entry book-keeping half a millennium ago.

IFRS 9 trifurcates assets into Stage I, Stage II and Stage III (ominous resemblance to a malignancy that afflicts humans!) and mandates provisions for 12-month Expected Credit Losses (ECL) for Stage I and Lifetime ECL for Stage II. The Current Expected Credit Loss or CECL standard proposed by FASB prefers to front-load lifetime expected losses. The expectation is that such risk-embedded accounting would prevent the next systemic financial fiasco.

Conceptually, the new accounting standard appears neat and sensible. What could create problems is the complexity it brings in. Modelling expected losses poses challenges. Data and its dissection apart, it is a bit hard to imagine that the economy would always behave as per our models and not throw up spanners in the works, potentially surfacing unexpected risks. Rapid technological advances or disruptive business models, for example, could lead entire industries to obsolescence, jacking up actual losses. Incurred loss is a reality; expected loss is an estimation.

In general, banks would have done considerable amount of technical heavy lifting to get the mechanics right as part of the preparatory to launch the new IFRS 9 standards or its national variants such as our Ind-AS. However, it is not evident as to how the industry would respond in case the new ECL-driven impairment model starts affecting profitability, making it difficult to practise the existing business models. Long tenor loans, say, for infrastructure or even housing might generate higher ECL. Economic sectors considered high-risk could also be no-go domains for some, if loss modelling shows up unacceptable outcomes. Besides credit ratings of counter-parties, collateral available might gain ascendency in credit decisioning. Banks may need to revisit their views on the kind of credit portfolio they wish to have as also their approach to pricing to minimise volatility in P&L and defend bottom lines. Overall, it may necessitate recalibration of risk appetites.

Transitioning from today's accounting to the new model would likely pose challenges for the auditing profession as well, in terms of granular data, time and resources they may require to crack through the complexities. Does one rely on model-driven expected loss numbers or dig deeper to assess the assumptions used in modelling the forward-looking scenarios? Extra work on translating accounts into different standards may also add up to costs. Businesses that deal with both the US and the rest of the world may need to deal with both IFRS and CECL—an inescapable complexity in this inter-connected world.

How do we guard against the unintended side effects of the complexity is a theme the global financial community may need to keep revisiting. Possibly, IFRS 9 would get fine-tuned to bring in greater simplicity, just the way Basel IV is emerging to handle unintended consequences and simplify risk measurement approaches. The new fair value IFRS 9 framework is academically appealing. Will it restore stability to the financial world that is looking to get its bearings back since the global financial meltdown? The short answer is 'no' but, hopefully, it should be of positive incremental value from risk management perspective.

Potential IFRS 9 outcomes might remind us of that old acronym, VUCA. In such an environment, financial institutions would be better off identifying the risk drivers underpinning their businesses and accordingly reorienting their business models, portfolio strategies and risk management practices.