

Firms with heavy debt may face credit squeeze

Proposed framework to progressively reduce the total exposure of banks to heavily indebted companies likely come into effect from financial year 2017-18

The Reserve Bank of India (RBI) on Thursday proposed to raise provisioning and risk weights for fresh loans given to highly leveraged companies. This is to discourage banks from lending to such companies, which are said to have caused a high concentration of credit risk in the banking sector.

RBI said it would bring a framework to progressively reduce the total exposure of banks to such corporate entities by revising down the normal borrowing limit of a company, irrespective of the group's size. The framework will likely come into effect from financial year 2017-18.

According to the framework, if the aggregate credit limit sanctioned by the banking system is more than Rs 25,000 crore at any time during financial year 2017-18, the company will be termed a special borrower. The threshold for the special borrower category would be reduced to Rs 15,000 crore in FY19 and Rs 10,000 crore from April 2019. If banks have to lend beyond 50 per cent of these limits in any year, they would have to provide more capital.

However, corporate entities could get a rate relief for their loans as banks could be given exemptions on interest rates to compensate for the additional provisioning and risk-weighted assets as a result of this framework.

Firms with heavy debt may face credit squeeze While banks have single company exposure limits set by their boards, generally 25 per cent of a bank's networth, there is no limit of how much a corporate entity can borrow from the banking system. As a result, these firms - mainly in the power/infrastructure, housing finance and steel sectors - have caused very large exposures to banks, RBI said in a discussion paper on its website.

"Many large corporates are excessively leveraged and banking sector's aggregate exposure towards such companies is also excessively high. This poses a collective concentration risk to the banking sector, even when the single and group borrower exposures for each bank remain well within the prescribed limits," RBI said.

The discussion paper is an extension of a similar release issued in March 2015, where the central bank said large companies should tap the markets to raise money through bonds once a cut-off level of borrowing is hit.

Abhishek Bhattacharya, co-head, bank and financial sector rating at India Ratings, said RBI's move comes when concentration risks are building up. As a prudent step, banks have been given a three-year transition period to move to the new regime.

This would ensure more supply of corporate paper in the market at a time when public sector banks, most of whom are capital starved, will have limited room to fund big-ticket loans.

Regulators have to also work to increase investor base for corporate securities (bonds, debentures, etc), Bhattacharya said.

RBI's data analysis on 77,036 borrower companies with sanctioned credit limits of Rs 1 crore and above point towards a high concentration of credit risk at the systemic level. RBI said its rule of limiting single borrower exposure linked to a bank's core capital might "not by itself be sufficient to contain the risk the banking system is exposed to."

However, putting a hard monetary ceiling on total loans, in the absence of a deep corporate debt market, might destabilise the credit intermediation process, RBI said.

"This may hamper credit growth in an already subdued economic environment and adversely impact the business cycle. It would also be difficult for banks to prune their existing exposures to corporates at short notice," it said. Under the framework, if a bank is found lending beyond the normally permitted limit, it has to set aside standard asset provision of three per cent on the incremental exposure and an additional risk weight of 75 per cent above the applicable risk weight for the exposure to the specified borrower. For the time being, banks will be allowed to invest in the bonds issued by the companies, but any extra bonds beyond the prescribed limit should be sold in the market completely in three years ending March 2021. By March 2019, banks should sell at least 30 per cent, by 2020 60 per cent and by 2021 they should sell all excess bonds beyond the permissible limits, RBI said.

(Business standard)