DEPARTMENT OF BANKING REGULATION

BANKING POLICY DIVISION

Discussion Paper – Framework for enhancing Credit Supply for Large Borrowers through Market Mechanism

In March 2015, RBI issued a Discussion Paper titled "Large Exposures Framework and Enhancing Credit Supply through Market Mechanism" for stakeholders' comments. Apart from introducing the contours of 'Large Exposures Standards' for banks in India, the Discussion Paper also focused on the need to encourage sources of funding other than bank credit for the corporate sector to finance growth. Specifically, the paper proposed ways to encourage large corporates with borrowings from the banking system above a cut-off level to tap the market for their working capital and term loan needs.

2. Subsequently, the Fourth Bi-monthly Monetary Policy Statement, 2015-16 dated September 29, 2015 made an announcement that the Reserve Bank will issue a draft circular on the subject. However, based on the comments received from the stakeholders on the discussion paper, and after examining several options for enhancing credit supply through market mechanism, it was felt necessary, as announced in the Monetary Policy Statement on April 5, 2016, to issue a separate Discussion Paper on the subject, for public comments, before finalising regulatory instructions in the matter.

3. Keeping the Reserve Bank's regulatory remit in perspective, the current Discussion Paper (DP) proposes a framework for managing the risk arising from the aggregate credit exposure of the banking system to a single large corporate.

4. Analysis of bank borrowings of Large Companies

In order to assess the current level of bank borrowings in relation to the overall indebtedness of corporate borrowers, an analysis was carried out in respect of the 77,036 borrower companies with aggregate sanctioned credit limits of Rs.1 crore and above, from banks, as on December 31, 2015 based on RBI's Central Repository for

Information on Large Credits (CRILC) database. In addition, financial data of borrower companies sourced from other databases was also used to supplement the analysis.

5. Rationale for the Proposed Framework

i. The data analysis, referred to above, points towards build-up of high concentration of credit risk at the systemic level in the banking sector. While single and group exposure norms put a ceiling on the amount an entity can borrow from a single bank, there is no ceiling on total bank borrowing by a corporate entity. This has resulted in banks collectively having very large exposures to some of the large corporates in India, particularly in the power/ infrastructure, housing finance and steel sectors/ industries. As observed from the analysis, 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 exposure limits.

ii. The need therefore arises for a framework that mitigates the risk posed to the banking system on account of large aggregate lending by the banking system to a single corporate as the single borrower exposure limit linked to a bank's Tier 1 capital may not by itself be sufficient to contain the risk the banking system is exposed to.

iii. There are several ways to address this risk. One could be to impose a hard monetary ceiling and the other to put in place prudential measures to recognise and provide for the associated risks. In the current context, it is the Reserve Bank's considered opinion that putting in place prudential risk recognition measures are preferable to imposing hard limits on banks' aggregate lending to large borrowers, due, among others, to the following reasons –

(i) Sudden imposition of a hard limit on aggregate lending to a corporate from the banking system may destabilise the credit intermediation process, in the absence of well-developed alternate channels. 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 the corporates at short notice.

(ii) The corporate bond market in India is not well developed and lacks depth – there are a number of constraints relating to the issuer and investor base, absence of robust secondary trading volumes, inadequacies of market infrastructure such as reporting, trading and exchange platforms, disclosure insufficiencies, etc. which need to be addressed at regulatory level separately.

In the circumstances the Reserve Bank proposes to introduce the Framework outlined in Section II below.

Section II

Framework for Recognising Risks in Large Exposures

Definitions

1. For the purpose of this Framework, the following terms shall have the meaning assigned to them herein below

(i) 'ASCL', means the aggregate of the fund based credit limits sanctioned to a borrower by the banking system

(ii) 'Specified borrower', means a borrower having an ASCL of more than
   a. Rs.25,000 crore at any time during FY 2017-18;
   b. Rs.15,000 crore at any time during FY 2018-19;
   c. Rs.10,000 crore at any time from April 1, 2019 onwards;

(iii) 'Reference date', means the date on which a borrower becomes a 'specified borrower'.

(iv) Normally permitted lending limit (NPLL), means 50 percent of the incremental funds raised by the specified borrower over and above its ASCL as on the reference date, in the financial years (FYs) succeeding the FY in which the reference date falls. For this purpose, any funds raised by way of equity shall be deemed to be part of incremental funds raised by the specified borrower (from outside the banking system) in the given year; Provided that where a specified borrower has already raised funds by way of market instruments and the amount outstanding in respect of such instruments as on the reference date is 15 per cent or more of ASCL on that date, the NPLL will mean 60 percent of the incremental funds raised by the specified borrower over and above its ASCL as on the reference date, in the financial years (FYs) succeeding the FY in which the reference date falls.

(v) Banking system, means all banks in India including RRBs and co-operative banks and branches of Indian banks abroad.

(vi) Market instruments, shall include bonds, debentures, redeemable preference shares and any other non-credit liability, other than equity.

The Framework

2. The framework will come into effect from the financial year 2017-18 onwards. The banking system shall ordinarily keep its future incremental exposures to the specified borrowers within the NPLL.

3. From 2017-18 onwards, incremental exposure of the banking system to a specified borrower beyond NPLL shall be deemed to carry higher risk which shall be recognised by way of additional standard asset provisioning and higher risk weights as under:

(i) Standard asset provision of 3 per cent on the incremental exposure of the banking system in excess of NPLL, which shall be distributed in proportion to each bank's funded exposure to the specified borrower.

(ii) Additional Risk weight of 75 per cent over and above the applicable risk weight for the exposure to the specified borrower. The resultant additional risk weighted exposure, in terms of risk weighted assets (RWA), shall be distributed in proportion to each bank's funded exposure to the specified borrower.

Explanation: For the purpose of determining exposure beyond NPLL, subscription to market instruments shall be included except any subscription made by the banking system to the market instruments issued by a specified borrower in 2017-18 and held within the permissible limits by a bank, as derived from para 4 below.

4. Banks may, at their discretion, subscribe to bonds issued by the specified borrowers (over and above NPLL) in the first year of this framework taking effect, i.e., 2017-18 subject to extant investment guidelines and these being sold off in the subsequent three years as per the following milestones:

(i) Not less than 30 percent by March 31, 2019
(ii) Not less than 60 percent by March 31, 2020
(iii) Not less then 100 percent by March 31, 2021.

5. All holdings by a bank of market instruments issued by a 'specified borrower' after the 'reference date' shall be held in the AFS/HFT category and marked to market as applicable thereto. However, banks may, at their discretion, value their holdings of

market instruments issued by the specified borrowers in 2017-18 at book value only to the extent of their holdings mentioned in para 4 above.

Lending rates to Specified Borrowers

6. Reserve Bank will provide specific exemptions from the provisions of its Master Directions on Interest rate on Advances to enable banks to charge differentiated interest rate to specified borrowers, to compensate for the additional provisioning and risk weighted assets as a result of this framework.

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