Syllabus subtopic: Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

News: Lenders seek exemption from RBI to relax the large exposure framework requirements for state-run firms

Prelims and Mains focus: about the recent disinvestments made by the govt and its impact on the credit flow and growth

What is the issue?

- A Reserve Bank of India (RBI) regulation meant to reduce concentration risk for banks is gradually choking the flow of funds to some large public sector enterprises, especially the oil marketing companies (OMCs) that have substantial debt requirements to meet capital expansion commitments.
- Lenders have sought an exemption from the central bank to relax the large exposure framework requirements for public sector companies.
- There are cases where funds have been sanctioned but the company is unable to draw it because of the regulations. As the exposure limit is based on 20% of a bank’s capital base, a possible solution seems to be for banks to raise more funds or wait for the upcoming mergers of state-run banks to grow their capital base.
- The large exposure framework, effective 1 April 2019, seeks to reduce concentration risk in the banking industry, already saddled with bad loans. It aims to align with the standards on supervisory framework for measuring and controlling large exposures issued by the Basel Committee on Banking Supervision (BCBS).
- As of September, gross non-performing assets (NPAs) of all banks was more than ?9.5 trillion. What has worsened the issue is the merger of ONGC and HPCL last year, resulting in exposures in two separate entities being clubbed as one.

What the RBI said:

All these entities are exceptions and only a few such companies are there with such large requirements and RBI’s objective is to de-risk large exposures of banks, said former RBI deputy governor R. Gandhi. “These entities are to raise capital and debt directly from the market. They have good ratings and can raise funds at competitive terms. Further, the merger of banks into international size can also help take care of these large requirements. These merged banks will have higher net-worth and, therefore, would be able to sanction larger limits to these entities,” he said.

Does disinvestment really helps?

- RBI had last October allowed OMCs to raise up to $10 billion through the external commercial borrowing (ECB) route for working capital needs. However, this does not cover loans required for capital expenditure or capex. Companies did not avail much of the ECB facility as lending rates are better domestically.
Recent stake sales by the government as a part of the disinvestment programme has resulted in some central public sector undertakings (CPSUs) becoming a part of connected counterparties and hence there might be little headroom for bank lending to individual CPSUs. 

In fact, even if such lending were to happen it would result in additional bank capital or higher risk weights resulting in elevated rates. 

It is, however, pertinent to add that public sector companies are not alone in their struggle for funds. Outstanding bank loans to industries grew by only 2.7% on a year-on-year basis in September to ₹27.74 trillion. On a year-to-date basis, these loans were 3.8% lower than March 2019.

Way ahead

Credit has to flow and move and while there is ₹2 trillion in the system, banks and the financial sector are sitting on extra credit. It is important that they get diverted. NPAs are part and parcel of any credit delivery system but that cannot be allowed to paralyse the flow of money.

About Basel Committee on Banking Supervision (BCBS)

The Basel Committee on Banking Supervision (BCBS) is an international committee formed to develop standards for banking regulation; as of 2019, it is made up of Central Banks and other banking regulatory authorities from 28 jurisdictions. It has 45 members.

Formed without a founding treaty, the BCBS is not a multilateral organization. Instead, the Basel Committee on Banking Supervision seeks to provide a forum in which banking regulatory and supervisory authorities can cooperate to enhance the quality of banking supervision around the world, and improve understanding of important issues in the banking supervisory sphere. The BCBS was formed to address the problems presented by globalization of financial and banking markets in an era in which banking regulation remains largely under the purview of national regulatory bodies.

Primarily, the BCBS serves to help national banking and financial markets supervisory bodies move toward a more unified, globalized approach to solving regulatory issues.