High time RBI cut bank exposure limits to big groups

Given how India's most indebted corporate groups, the ones that figure in Credit Suisse's *House of Debt* series, account for 12-13% of all banking debt in the country, it was always critical that the central bank look at curtailing bank exposure to such groups. Indeed, at an aggregate level of India Inc, the debt held with firms who have an interest cover of less than one has risen, and in Q1FY17, 39% of all debt was with these firms – that is, bank exposure to even firms not belonging to the most indebted groups is problematic. Since a large part of this debt was given due to political and other considerations, then RBI Governor Raghuram Rajan had explained how it added to the costs for other borrowers. Though the policy rate was just 8%, Rajan had said, loans to the power sector were priced at 13.7% – the difference was the risk premium attached to such lending. Right now, though bank exposures to individual firms are limited to 15% of the bank's capital and to 40% in the case of groups, this can be raised to 25% and 55% once you take into account the relaxations for infrastructure, primarily. Given the trouble infrastructure loans are causing banks, it is safe to say that had the central bank lowered exposure limits earlier, the problems of the banking sector would be much less than they are today.

In March 2105, RBI did move to lower exposure limits and its discussion paper talked of how the Basel Committee on Banking Supervision (BCBS) recognised the need for banks to measure and limit the size of large exposures in relation to their capital – according to the BCBS standards, the sum of all the exposures of a bank to a single counterparty or to a group of connected counterparties was to be restricted to 25% of the bank's capital base; the framework was to be fully applicable from January 1, 2019. The final guidelines have now been notified, after a discussion process, and will be applicable from April 1, 2019. While the norm for individual firms has been restricted to 20%, it can go up to 25% based on a board-approved policy with clear rules for the relaxation. For groups of connected counter-parties, the limit has been capped at 25%. The restriction in limits are of no use when it comes to resolving the current NPA mess – NPAs and restructured assets have risen from 10% of loans in FY14 to 12.1% in Q1 FY17 – but will go a long way in ensuring banks don't have to face the same mess again as corporate debt – at the level of both an individual firm as well as a group – will now be shared more evenly between banks and bond markets.