

Credit-cap norm may curb banks from lending to firms eyeing distressed assets

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MUMBAI, JANUARY 28

The fear of breaching regulatory exposure and ceiling limits relating to single borrower and borrower group may hold back banks from enhancing credit limits to large corporate clients looking to acquire large distressed assets put on the block under the Insolvency and Bankruptcy Code (IBC).

Flagging the possibility of banks running afoul of regulatory exposure ceiling limits, a top public sector bank official said that when a large corporate, say, in the steel sector, acquires another large distressed steel-maker, the credit requirement of the former could exceed the prescribed exposure ceiling.

“Bidders for these large distressed companies, which have been proceeded against by banks under the IBC, are limited in number. Also, these bidders (usually large companies with deep pockets) are already availing themselves of credit facilities from the banking system. Although the bidders are financially sound and bankable, nevertheless once they acquire a distressed company, it becomes their group company. Now, suppose the Tatas takeover a large steel company. As a result, banks’ exposure to the Group will go up, thereby increasing the concentration risk,” said the banker quoted above.

The Tatas, for example, are already having huge credit limits from the banking sector. So, the group exposure could go up significantly for banks if they acquire a distressed asset.

Exposure norms

As per extant Reserve Bank of India’s norms for banks, the (loan) exposure ceiling limits are 15 per cent of capital funds (comprising Tier-I and Tier-II capital) in case of a single borrower, and 40 per cent of capital funds in the case of a borrower group.

However, with effect from April 1, 2019, the RBI has prescribed that the sum of all the exposure values of a bank to a single counterparty and group of counterparties must not be higher than 20 per cent (bank boards may allow an additional 5 per cent exposure) and 25 per cent, respectively, of the bank’s available eligible capital base (Tier-1 capital) at all times.

Once the new norms pertaining to large exposure framework (LEF) kick-in, from April 1, 2019, banks will have to restrict their exposure to large corporates as the definition of what constitutes an eligible capital has been re-defined.

Currently, capital funds comprise Tier-I and Tier-II capital but under the LEF, eligible capital takes into account only Tier-I capital.

PE lending

Bankers say extending fresh loans to distressed companies acquired by private equity (PE) funds will be difficult as there is no hard-core promoter behind such funds, which typically wait for industry or company specific revival to happen and seek an exit over a defined period, say, three or five years. “In case anything goes wrong post-acquisition of a company by a PE, banks will not be in a position to catch hold of somebody or speak to somebody who could help us with a solution or resolution to issues which may crop up, going forward,” said another banker.

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