

Guarantees offered by banks outside India on the rise, touch ₹1.95 lakh cr

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In 2016-17, public sector banks held about two-thirds of such guarantees

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The non-fund exposure of banks, reported as a contingent liability in the books, has understandably drawn ample attention after the ₹13,000-crore LoU (letter of undertaking) scam hit Punjab National Bank. Contingent liabilities include LoUs, guarantees and foreign exchange contracts.

According to RBI data, of the total contingent liabilities, guarantees outside India by all scheduled commercial banks have grown at a compound annual growth rate of 21 per cent since 2004-05, while banks' assets during this period have grown by a lower 16 per cent.

From about ₹18,800 crore in 2004-05, guarantees outside India stood at ₹1.95 lakh crore in 2016-17.

Banks issue guarantees on behalf of their customers for various purposes. The guarantees executed by banks comprise both performance and financial guarantees. While some bankers are of the view that the rise in offshore guarantees could be an offshoot of India's growing external trade, enforcement on the assets or the legal recourse available to banks with regard to guarantees outside India could be fraught with challenges.

“The guarantees outside India can typically be issued for securing overseas funding for acquisition purposes or for contractual performance of Indian corporates.

“In case these are not secured by other forms of collateral or counter-guarantees, the likelihood of a recovery can be uncertain as repossession of the overseas assets will be governed by the laws of respective countries,” says Anil Gupta, Vice-President, Sector Head – Financial Sector Ratings, ICRA.

Public sector banks (PSBs) held about 67 per cent of the guarantees outside India as of 2016-17, up from about 60 per cent in 2004-05. The growth has been led by SBI (and its associates), its share going up substantially from 30 per cent in 2004-05 to 38 per cent in 2016-17.

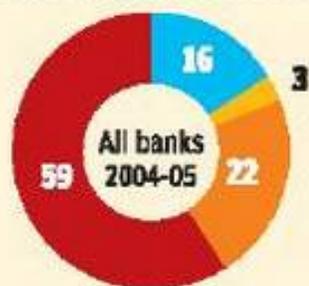
While private sector banks too have reported robust growth in such guarantees, their share is lower at 14 per cent. Interestingly, foreign banks have seen a steep fall in their share — from 31 per cent in 2004-05 to 19 per cent in 2016-17.

SBI and its associates (around ₹74,924 crore), Bank of India (₹21,064 crore), ICICI Bank (₹20,319 crore) and PNB (₹13,920 crore) are among Indian banks with large guarantees outside India in absolute terms in 2016-17. As a percentage of assets, they are about 2-3 per cent.

Robust growth in guarantees

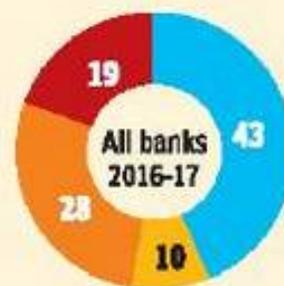
	Guarantees (₹ crore)				CAGR%	
	In India		Outside India		In India	Outside India
	2004-05	2016-17	2004-05	2016-17		
All banks	1,04,639	8,87,770	18,838	1,95,795	19.5	21.5
SBI & its associates	17,573	1,60,817	5,605	74,925	20.3	24.1
Other nationalised banks	50,662	3,25,780	5,657	56,127	16.8	21.1
Private sector banks	23,020	3,13,317	1,765	28,342	24.3	26.0
Foreign banks	13,383	87,793	5,812	36,401	17.0	16.5

A big shift in bank's non-fund exposure



% share in contingent liabilities (excluding forex contracts)

- Guarantees in India
- Guarantees outside India
- Acceptances, endorsements and other obligations
- Others*



*others include (a) claims against the bank not acknowledged as debt, (b) liability for partly paid investments, (c) bills re-discounted, and (d) letters of credit

Source: RBI

Guarantees up

The RBI's data on contingent liabilities consist of guarantees in and outside India, acceptances, endorsements and other obligations, liability on account of outstanding forward exchange contracts and others, including bills rediscounted and letters of credit.

Forward exchange contracts (all derivative products, including interest-rate swaps) form the chunk of banks' contingent liabilities, at 86 per cent in 2016-17.

However, experts believe that since the gross value of derivative contracts are reported, they may not be an accurate assessment of risk. Hence, for our study, we have excluded such contracts from banks' exposure to non-fund liabilities.

As a per cent of total contingent liabilities, excluding forex contracts, there has been a significant increase in the share of guarantees. From 19 per cent in 2004-05, the share of guarantees both in and outside India constituted 52 per cent of contingent liabilities for all banks in 2016-17.

While the share of guarantees in the overall banking system has gone up sharply over the past decade, the share of other contingent liabilities such as bills re-discounting and letters of credit has fallen steeply.

From 59 per cent of contingent liabilities (excluding forex contracts) in 2004-05, the share of other contingent liabilities aside from guarantees and acceptances has fallen to 19 per cent in 2016-17.

“Bill re-discounting is typically governed by the cost of foreign currency funding for the banks. In case banks can raise funding at competitive rates, the re-discounting volumes will typically go down. During periods like the sub-prime crisis of 2008-09 or taper tantrum period of 2014, when the cost of funding went up for Indian banks, the re-discounting volumes increased.

“Subsequently, with improving macro-economic fundamentals the cost of funding declined, thereby reducing the bill re-discounting volumes,” says Anil Gupta.