Bank margins may be hit as new RBI norms push firms to bonds

K Ram Kumar Mumbai | Updated on March 13, 2019 Published on March 13, 2019

Banks seen upping investment in bonds floated by India Inc

Come April 1, banks' margins could come under pressure as the Reserve Bank of India's stringent guidelines on corporate lending will see India Inc increasingly tap the bond market for its funding requirements.

In view of the guidelines, banks are expected to shift gears to cater to the demand for funds by stepping up investments in bonds issued by corporates.

What could nudge banks to re-work their credit growth strategy by upping their participation in the bond market, beginning FY2020, are the two RBI guidelines pertaining to the 'Loan System for Delivery of Bank Credit' and 'Enhancing Credit Supply for Large Borrowers through Market Mechanism'.

Under the 'Loan System for Delivery of Bank Credit' guideline, in the case of borrowers having an aggregate fund-based working capital limit of ₹150 crore and above from the banking system, the limit has to be carved out into two components — working capital limit or 'loan component' (40 per cent of the aggregate limit) and cash credit (60 per cent) with effect from April 1.

The central bank has stipulated that drawings up to 40 per cent of the overall fund-based working capital limits will only be allowed from the ‘loan component’ and drawings in excess of the minimum ‘loan component’ threshold will be allowed in the form of cash credit (CC) facility.

So, borrowers will not only pay interest on the 40 per cent loan component and drawings from CC limit, but may also have to pay commitment charges on the unavailed CC limit.

The guideline on ‘‘Loan System for Delivery of Bank Credit’ along with the norms on ‘Enhancing Credit Supply for Large Borrowers through Market Mechanism’, whereby large borrowers are required to access 50 per cent of their incremental funding requirement via market instruments, could see India Inc tap the bond market in a big way, with banks also investing in these instruments, say bankers.

So, in a bid to rein-in borrowing costs, corporates are expected to tap the bond market progressively for their short- and long-term funds. This, in turn, will impact banks’ margins as the return on assets in the case of loans is generally higher than the return on investment on market instruments.

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