Why banks are turning conservative when investing in commercial papers, MFs

K Ram Kumar Mumbai | Updated on August 26, 2019 Published on August 26, 2019

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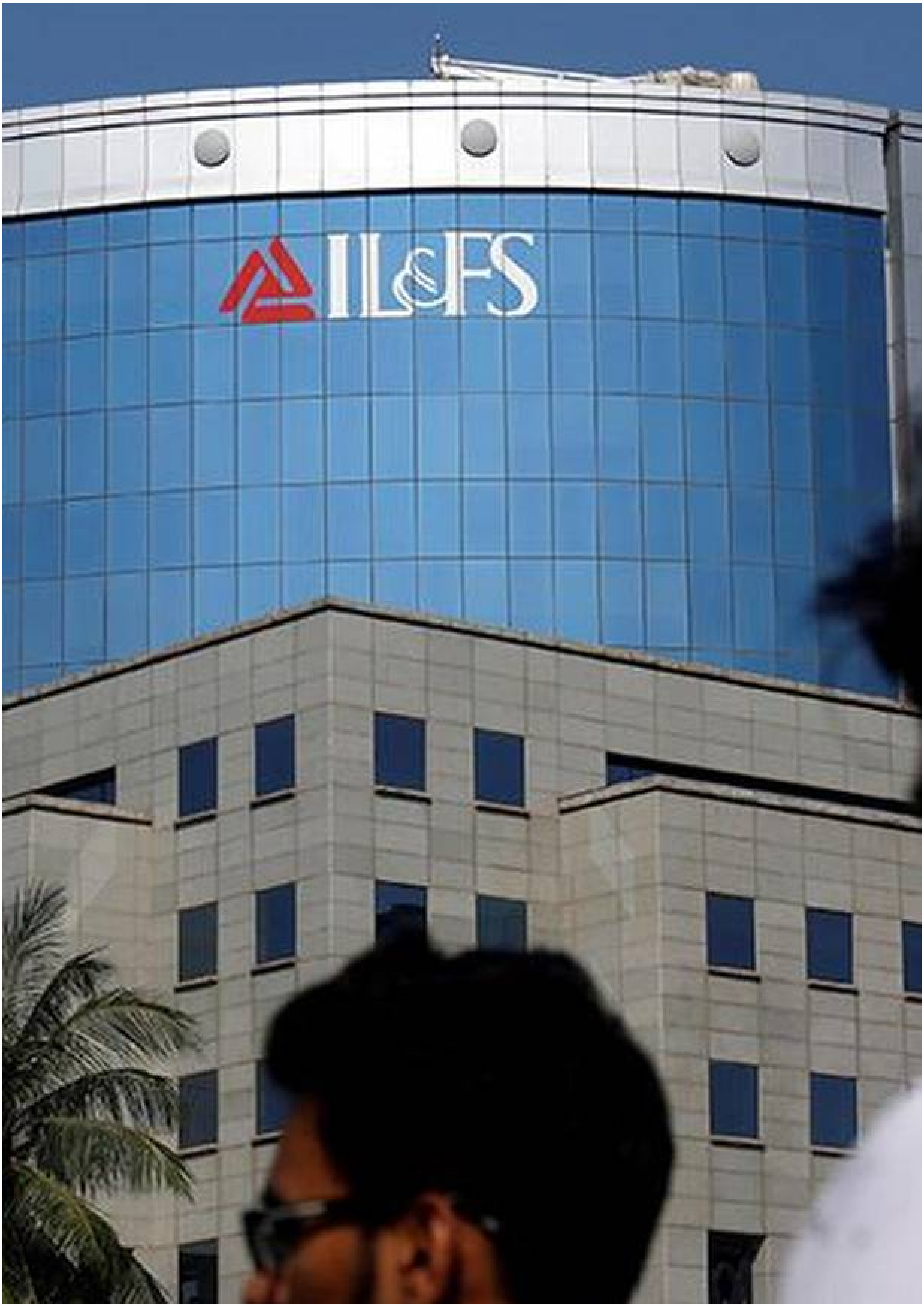
IL&FS

G-Sec investments, however, edge up Y-o-Y till June 21

Banks have become selective with investments in commercial papers issued by India Inc. They have also curtailed investments in mutual funds following defaults on debt by IL&FS, DHFL, and Cox & Kings.

This is underscored by the fact that banks' investment in commercial papers (CPs) contracted 24 per cent year-on-year (y-o-y) at ₹97,240 crore as on June 21, 2019, against ₹1,27,420 crore as on June 22, 2018.

Further, as per Reserve Bank of India data, banks' investment in instruments (units) issued by mutual funds declined 22 per cent y-o-y at ₹55,630 crore as on June 21, 2019, against ₹71,540 crore as on June 22, 2018.

RK Gurumurthy, Head-Treasury, Lakshmi Vilas Bank, said: "As part of liquidity management, we invest short-term excess liquidity in money market instruments such as CPs of top-rated issuers. After the September 2018 NBFC debacle, where defaults by IL&FS and DHFL led to sharp rating downgrades and liquidity crisis, we are extremely cautious and selective in our investment decisions.

"Investment policies have undergone significant changes and the bank invests selectively in top-rated companies and instruments."

This, however, has a flip side: The coupon/yield of highly-rated companies for shorter maturities is well below 7 per cent, while the cost of funds, adjusted for reserve and capital costs, may still be too prohibitive to invest in these CPs.

"Therefore, we are less inclined to invest in such money market instruments, and this could well be the case across the system. Credit risk is an additional deterrent," explained Gurumurthy.

CPs are unsecured money market instruments issued by corporates and financial institutions in the form of promissory notes. They are usually issued with fixed maturities from one day to 270 days for financing accounts receivables, inventories, and meeting short-term liabilities.

Safe haven G-Secs

Even as their investments in CPs and financial instruments issued by mutual funds dwindled, banks' investments in Central government securities (G-Secs), including Treasury Bills, and State government securities, edged up to stand at ₹34,66,650 crore as on June 21, 2019, against ₹33,96,560 crore as on June 22, 2018.

G-Secs are tradable instruments issued by the Central or State Governments, acknowledging their debt obligation. Such securities are short-term (Treasury bills with original maturities of less than one year) or long-term (government bonds or dated securities with original maturity of one year or more).

Credit quality

Gurumurthy observed that in view of the deteriorating credit quality, the difference (in yields) between top-rated companies and others is so wide that banks cannot afford to invest in the former, and yet expect to make a profitable spread.

Hence, he emphasised: "We are rather comfortable in staying invested in risk-free gilt-edged securities. To the extent ALM (asset liability management) gaps allow, investment in Treasury bills is even better as there is no mark-to-market risk."

Wary of MFs

Market players say banks' investment philosophy in mutual funds has undergone a change. Newer valuation guidelines and crisis-of-credit-confidence has been a key factor for staying away from these investments for sometime now.

According to Gurumurthy, return of capital rather return on capital is the guiding mantra for banks now.

With some NBFCs facing liquidity issues due to the ripple effect of debt defaults by the IL&FS Group, which predominantly funded infrastructure projects, they have turned conservative in lending. In fact, NBFCs have been selling pools of assets to banks to generate liquidity so that they can originate new business.

So, pool purchase of assets is also one of the reasons why banks' non-food credit increased 12 per cent y-o-y to ₹94,77,500 crore as on June 21, 2019, against ₹84,53,140 crore as on June 22, 2018.

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mutual funds **short-term instruments** **banking**

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COMMENTS