OVERVIEW OF CREDIT MANAGEMENT

CHAPTER 17 MODULE C PART 2 By Ashish Sir

STATUTORY OTHER RESTRICTIONs

Banks in India are able to lend as per their Board approved policies now. RBI provides only gives overall guidelines. However, Banks have to abide certain statutory restrictions as follows:

Advances against Bank's Own Share

In terms of Section 20(1) of the Banking Regulation Act, 1949, a bank cannot grant any loans and advances on the security of town shares

Advance to Directors of the Bank

- Banks are prohibited from any commitment for granting any loans and advances to or on behalf of any of its directors, or to any firm in which any of its directors is interested as partner, manager, employee or guarantor for any company of which, or subsidiary of the holding company of which any of the directors the Bank is the director managing agent, manager, employee or guarantor or in which he owns substantial Interest, or to any individual in respect of whom any of its directors is a partner or guarantor, other than those exemptions permitted with respect to type of facilities

- Unless sanctioned by the Board of Directors/ Management Committee, banks should not grant loans and advances aggregating Rs. 500 lakh and above to Directors, Chairman/ Managing Director of other banks

Credit to Co's for Buy-back of their Securities

Banks should not provide loans to Co's for buy-back of shares / securities

Industries Producing / Consuming Ozone Depleting Substances (ODS)

India is a party to the **Montreal Protocol** and therefore Ozone Depleting Substances (ODS) are required to be phased out as per schedule prescribed therein from. The Banks should not extend finance for setting up of new units consuming/producing the above ODS.

The **Montreal Protocol** is an international treaty designed to protect the ozone layer by phasing out the production of numerous substances that are responsible for ozone depletion.

Sensitive Commodities under Selective Credit Control (SCC) Sec 21 of Banking Regulation Act

With a view **to preventing speculative holding of essential commodities** with the help of bank credit and the resultant rise in their prices, Reserve Bank of India, issues the commercial banks from time to time stipulating specific restrictions on bank advances against specified sensitive commodities

Capital market exposure (Loans & Advances against Shares, Debentures and Bonds etc.)

Banks are to observe regulatory restrictions on grant of loans and advances against shares, debentures and bonds as per RBI guidelines

Money Market Mutual Funds

- Earlier RBI used to issue guidelines on exposure to Money Market Mutual Funds.
- However, the guidelines are since withdrawn and the Banks are to be guided by the SEBI Regulations only

Advances against Fixed Deposit Receipts (FDR) by Other Banks

- As there have been instances where fake term deposit receipts, purported to have been issued by other Banks
- RBI has advised that the banks should desist from sanctioning advances against FD, or other term deposits of other banks.

Loans against Certificate of Deposits (CD)

- Banks cannot grant loan against CDs.

- Furthermore, they are also not permitted to buy-back their own CDs before maturity.

COMMON GUIDELINES/ INSTRUCTIONS FOR LENDING TO MSME SECTOR:

1. **Acknowledgement of Loan Applications**:
   - **Mandatory Acknowledgement**:
     - Banks must acknowledge all MSME loan applications (manual or online) and **provide a running serial number** on the application and the receipt.
   - **Systems to be Implemented**:
     - Central registration for loan applications.
     - Online submission and e-tracking of MSME loan applications.

2. Collateral Requirements:
   - **Collateral-Free Loans**:
     - **No collateral is required for loans up to** ₹10 lakh **for MSEs.**
     - Loans under the **PMEGP (Prime Minister Employment Generation Programme)** up to ₹10 lakh are also collateral-free.
   - **Enhanced Limits**:

  - Collateral-free loans can be extended up to **₹25 lakh** for MSEs with a good track record and financial standing (subject to authority approval).
- **Credit Guarantee Scheme**:
  - Banks are **encouraged to utilize the Credit Guarantee Scheme** to cover these loans and should evaluate staff performance based on their usage of this scheme.

3. **Composite Loan**:
   - **Single Window Facility**:
     - A **composite loan limit of ₹1 crore** can be sanctioned to MSEs, covering both working capital and term loan needs.
4. **Credit Linked Capital Subsidy Scheme (CLSS)**:
   - **Technology Upgradation**:
     - Provides a **15% upfront capital subsidy** up to **₹15 lakh** (investment in approved machinery capped at ₹1 crore).
     - Applies to MSEs including tiny, khadi, village, and coir units.
   - **Eligible Uses**:
     - Upgrading technology to improve productivity, product quality, work environment, packaging, energy conservation, pollution control, and in-house quality testing.
5. **General Credit Card (GCC)**:
   - **Purpose**:

- To provide credit for entrepreneurial activity in the **non-farm sector**.

- **Eligibility**:
  - All non-farm entrepreneurial credit under priority sector guidelines qualifies.
- **Features**:
  - Covers both working capital and term loans.
  - May be issued as **Smart Cards/Debit Cards** compatible with ATMs and swipe machines, storing identity, assets, and credit profiles.

6. **Streamlining Credit Flow to MSEs**:

- **Life Cycle Support**: Banks should provide financial assistance to MSEs during critical phases of their lifecycle.
- **Key Measures**:
  - **Standby Credit Facility** for term loans.
  - **Additional Working Capital** for emergent needs.
  - **Mid-term Review** of working capital limits annually, based on previous year's sales.
  - **Timelines for Credit Decisions** to ensure timely approvals.

LARGE EXPOSURE FRAMEWORK (LEF)

The **Reserve Bank of India (RBI)** introduced the LEF to align with international standards (BCBS) and improve risk management by **limiting credit exposure to single counterparties or groups** of connected counterparties. The LEF became effective from **April 1, 2019**.

Definition of Large Exposure: **Large Exposure**: When a bank's exposure to a counterparty or group of connected counterparties equals or exceeds **10% of its Tier-I Capital**.

Key Guidelines:

(a) Exposure Limits for Non-NBFC Borrowers:

- **Single Counterparty**: Limited to **20%** of the bank's Tier-I Capital.
  - An **additional 5%** can be allowed in exceptional cases with board approval.
- **Group of Connected Counterparties**: Limited to **25%** of Tier-I Capital.
- **Criteria for Connected Counterparties**:
  1. **Control Relationship**: When one entity directly or indirectly controls the other(s).
  2. **Economic Interdependence**: If financial issues (like repayment difficulties) faced by one counterparty will affect the others.

- **Special Rule**: Mandatory identification of economic interdependence for exposures exceeding **5% of Tier-I Capital**.
- **Exemptions**:
  - Entities connected to sovereigns (e.g., Government of India) are excluded from the connected counterparty group definition.

(b) Exposure Limits for NBFCs:

- **Single NBFC**: Limited to **20%** of Tier-I Capital.
- **Group of Connected NBFCs**: Limited to **25%** of Tier-I Capital.
  - Additional **5% forbearance** is **not allowed** for NBFCs.
- **Enhanced Restrictions**: Stricter limits may apply based on risk perception for certain NBFC categories.
- **Capital Augmentation**: Infused capital after the published balance sheet date can be included, but banks must submit an auditor's certificate to RBI.

LOOK THROUGH APPROACH (LTA):

Purpose: Determines counterparties in **structures like collective investment vehicles and securitization transactions.**

Rule:

- If a bank's exposure to such a structure is **≤ 0.25% of Tier-I Capital**, the structure is treated as a single counterparty.

- **For exposures exceeding 0.25%,** the total is assigned to an "unknown client" and treated as a single counterparty for risk management.

Exemptions under LEF:

1. **Government and RBI**:
    - Exposures to Government of India (GOI), RBI, and State Governments.
    - **Fully guaranteed loans by the GOI or secured by GOI financial instruments.**
2. **Central Banks**: Foreign sovereigns and central banks (when denominated in their domestic currency and met out of the same resources).
3. **Special Exemptions**:
    - Intra-day interbank exposures.
    - Intra-group exposures (covered under other RBI norms).
    - Food credit borrowers with authorized limits.
    - Clearing exposures to **Qualifying Central Counterparties (QCCPs)**.
    - Deposits maintained with NABARD for priority sector shortfalls.

Exposure to Consortium/ Multiple Banking Borrowers:

Banks must consult with other member banks to maintain consistency when identifying a group of connected counterparties.

Statutory and Regulatory Restrictions on Certain Credits

Prohibited/Restricted Advances, Investments, and Activities

1. **Advances/Investments Prohibited**:
    - **Own Shares**: Banks cannot advance loans or invest in their own shares.
    - **Directors & Relatives**: (500 Lakhs without approval)
        - Prohibited from granting loans or making investments to directors, their relatives, or entities in which they have an interest.
        - Applies to directors of other banks as well as senior officials and members of sanctioning committees.
    - **Deposits of Other Banks**: No loans or advances against fixed deposits (FDRs) or other term deposits of other banks.
    - **India Depository Receipts (IDRs)**: No financing against IDRs.
2. **Prohibitions Related to Gold and Bullion**:
    - Loans against **bullion**, **primary gold**, or **gold ETFs and mutual funds**.

- Financing for the purchase of gold in any form.

3. **Environmental Restrictions**:
   - Prohibited from financing industries producing or consuming **Ozone Depleting Substances (ODS)**.
   - Restriction on financing units using **chlorofluorocarbons (CFCs)** in their manufacturing processes.
4. **Arbitrage and Buy-back Operations**:
   - Loans for **arbitrage operations** are restricted.
   - Financing the **buy-back of shares or securities** is prohibited.
5. **Sensitive Commodities**: (Sec 21 BR Act): Restriction on financing **sensitive commodities** under the **Selective Credit Control (SCC)** framework.
6. **Promoter's Contribution**: Banks cannot finance **promoter's contribution** for any project.
7. **Market-Related Restrictions**:
   - Loans/ advances to **stock and commodity brokers**, **market makers**, and similar entities are restricted.
   - Financing against **shares**, **convertible debentures/bonds**, and **units of equity-oriented mutual funds** is prohibited.
8. **Venture Capital Funds (VCFs)**: Banks are restricted from providing any exposure to **VCFs**.

9. **Certificate of Deposits (CDs)**: Banks are not allowed to buy back their own **Certificates of Deposits (CDs)**.

Enhancing Credit Supply for Large Borrowers through Market Mechanism

The **Reserve Bank of India (RBI)** has issued **guidelines to regulate credit supply to large borrowers by encouraging a market-based funding mechanism**.

Key Highlights of the Guidelines

1. **Definition of Specified Borrower**:
   - A **Specified Borrower** is any borrower with an **Aggregate Sanctioned Credit Limit (ASCL)** exceeding **₹10,000 crores** from the banking system.
   - *ASCL refers to the total of **fund-based credit limits sanctioned or outstanding**, whichever is higher, across all banks.*
2. **Normally Permitted Lending Limit (NPLL)**:
   - The **NPLL** for a Specified Borrower is defined as **50% of the incremental funds** raised by the borrower beyond its ASCL as of the **reference date**.
   - The **reference date** is the date when the borrower is categorized as a **Specified Borrower**.
3. **Provisions for Lending Beyond NPLL**:

- If banks lend to a Specified Borrower beyond the NPLL, such incremental exposure will attract the following:
  - **Additional Provisioning**: **3 percentage points over and above the applicable provisioning norms.**
  - **Additional Risk Weight**: **75 percentage points over and above the applicable risk weight.**

4. **Objective**:
   - The framework aims to **reduce concentration risk** in the banking system.
   - It encourages large borrowers to raise funds through **alternative market mechanisms**, such as corporate bonds and commercial paper, rather than relying solely on bank financing.