CORPORATE & INTERNATIONAL BANKING

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To

The Chief Executives of All Member Banks

Dear Sirs/Madam,

Rationalisation of the Cash Credit Facilities

Reserve Bank of India (RBI) in September 2013 forwarded a draft circular on “Alternate approach to Working Capital (WC) financing for large Corporate Borrowers” to the Indian Banks’ Association (IBA) for comments. RBI was examining a proposal to replace the existing cash credit system in respect of working capital facilities exceeding ₹250 crores by converting the existing facilities to the extent of 10% by tapping corporate bond market to fund the core working capital requirement. IBA’s member banks were of the view that:

i. The tenor of the bonds be kept between 3-5 years.
ii. Sharing of securities and collaterals between the bond holders and working capital providers would be a challenge in view of the drawing power related issues.
iii. Investment by working capital lenders in the bonds would be subject to board approved investment policies and the regulatory prescriptions.

2. IBA has now received a communication from a member bank pointing out that cash credit mechanism; particularly the large limits pose serious liquidity challenges to banks. The banks are often required to resort to expensive emergency funding to meet the prudential obligations. The bank recommended a need to reduce the burden of Cash Credit (CC) on the banking system and the liquidity management. The way suggested was to sanction a significant portion of limits through a combination of a Bill Discounting Limit and a Working Capital Demand Loan (WCDL) Limit. The WCDL can be used for drawings for short term durations, of say one to six month, as may be mutually agreed between the bank and its Customer. In this Working Capital mix, WCDL component would carry commitment fee as per RBI’s / individual bank’s guidelines and the CC facility could carry a rate of interest commensurate to the borrower’s credit rating. Banks may also compulsorily introduce a cancellability clause in all CC sanctions.

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3. The matter was placed in the Managing Committee (MC) meeting of the Association for discussion. The Committee noted that RBI had introduced a loan system for delivery of bank credits; vide its circular no. IECO.No.43/08.12.01/94-95 dated April 21, 1995. Banks were given freedom to change the composition of Working Capital facilities exceeding ₹ 20 crores with a cash credit component and a loan component. The present proposal is within the ambit of the RBI’s instructions.

4. The MC was of the view that to manage the liquidity of banking system, it is necessary for banks to sanction a significant portion of their Working Capital facilities with Bill Discounting Facilities and a WCDL component of short term duration as permitted by RBI. To begin with the banks may structure at 50% of the Working Capital limit sanctioned to the large borrower, say exceeding ₹ 250 crores. As the proposed structure of Working Capital facilities, as detailed in para 2 above falls within the ambit of RBI’s dispensation, the Committee was of the view that this system can be adopted by the banks straightaway.

5. As a consequence of the proposed changes in the Cash Credit system, banks will need to be extra cautious in monitoring conduct of their borrowers’ accounts, especially those under the Consortium and Multiple Banking Arrangements. As a substantial part of banks’ lending would be by way of WCDL and Bills Discounting facility, a close watch on the available drawing power, bills realization, book debt management and end-use of funds would be necessary.

6. The member banks are requested to take a note of the decision of the Managing Committee. A copy of this communication is being sent to Reserve Bank of India.

Yours faithfully,

(Sangeet Shukla)
Senior Advisor