



Indian Banking Sector August 2020

Current account balances
could decline and shift
among lenders; Could
increase cost of funds for
some banks.

Push borrowers to improve
financial discipline



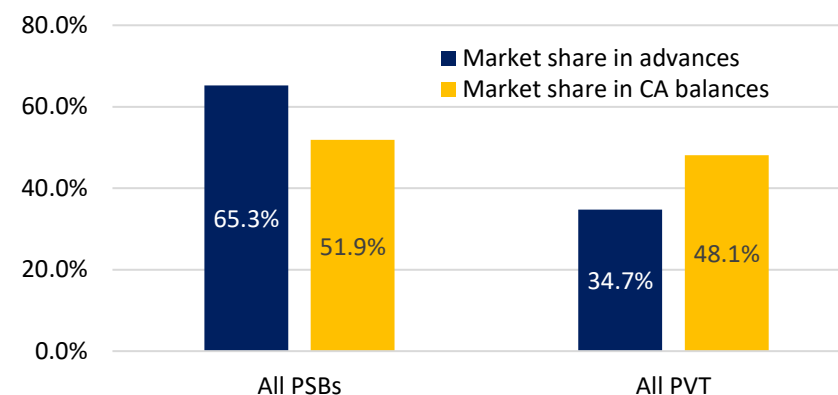
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Highlights

- Reserve Bank of India (RBI), has issued a [notification](#) on August 6, 2020, disallowing banks from opening current account (CAs) for customers who have credit facilities in form of cash credit (CC) / overdraft (OD) from the banking system.
- Earlier RBI had issued a [similar directions](#) for not opening of CAs by non-lending banks, however with this notification, RBI has put additional restrictions on opening of CAs and checks and balances on operation of the CAs.
- A bank with less than 10% of the total banking exposure (fund + non-fund) to the borrower can use the CC/OD account only for the debits to the CC/OD account of the borrower maintained with other bank having 10% or more of the banks' exposure to the borrower.
- Thus, the CC/OD accounts could become the key operative accounts for the borrowers and the CA balances of a customer with CC/OD accounts could reduce
- The RBI circular is intended to enable lenders to have a better control on borrowers' cash flows and monitoring the same. The measure may also improve discipline among the borrowers as instances of diversion of funds could come down.
- As can be seen from Exhibit 1, with ~65% share in the bank credit, PSBs have a relatively lower share of ~52% in the CA deposits of the banking system, as PVBs enjoy a better float of CA balances from their customers.
- A relatively higher share of CA balances of private banks is also driven by their better service levels such as doorstep cash management services, better tapping of the entire value chain in customer's eco-system, better interface of internet banking systems etc.
- CA deposits accounted for ~13.1% of total deposits for private banks, ~6.7% for public banks and overall ~9.3% for the banking system
- Since the CC/OD account will become the key operative account for borrowers, the loan and deposit balances for a borrower are likely to decline. This may result in decline in overall CA balances for banking system and possibly some shift in the CA balances among the private banks (PVBs) and public banks (PSBs)
- Lower CA balances could also lead to higher costs of funds which could increase from 5bps to 30 bps (refer exhibit 6) depending on the current share of CA balances in overall deposits and the extent of future decline in CA balances
- Banks will need to identify other revenue sources from these customers to maintain their profitability
- This may also lead to some reduction in number of lending relationships for a borrower, as the banks may try to increase their lending share to more than 10% of the banking exposure of the borrower
- The on-balance sheet liquidity of some corporates may also be monitorable as this liquidity could be maintained outside the lending banks

EXHIBIT 1: Market share in CA deposits and advances



Source: Banks, ICRA Research. As on March 31, 2020

Some PVBs have relatively higher share of CA balances in relation to overall deposit base as well as market share in credit

EXHIBIT 2: Most PSBs have lower share in CA deposits in relation to system

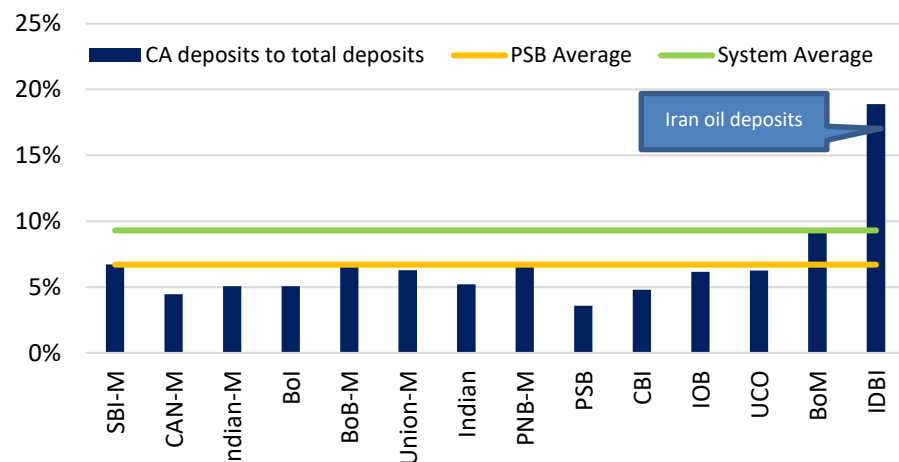


EXHIBIT 3: large PVBs enjoy higher CA deposits because of better service levels

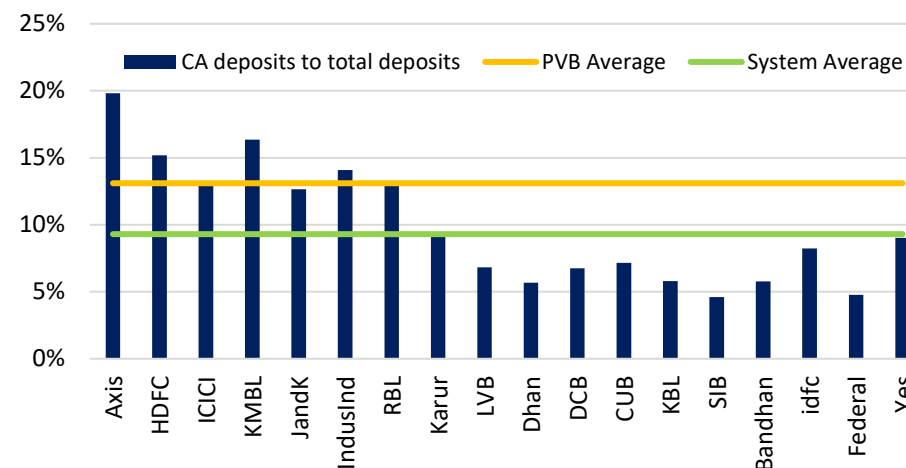


EXHIBIT 4: Most PSBs have lower share in CA deposits vis a vis share in advance

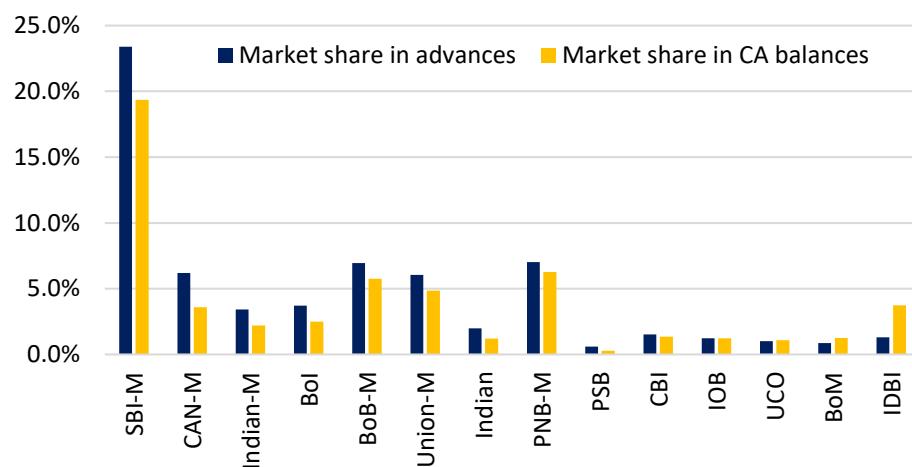
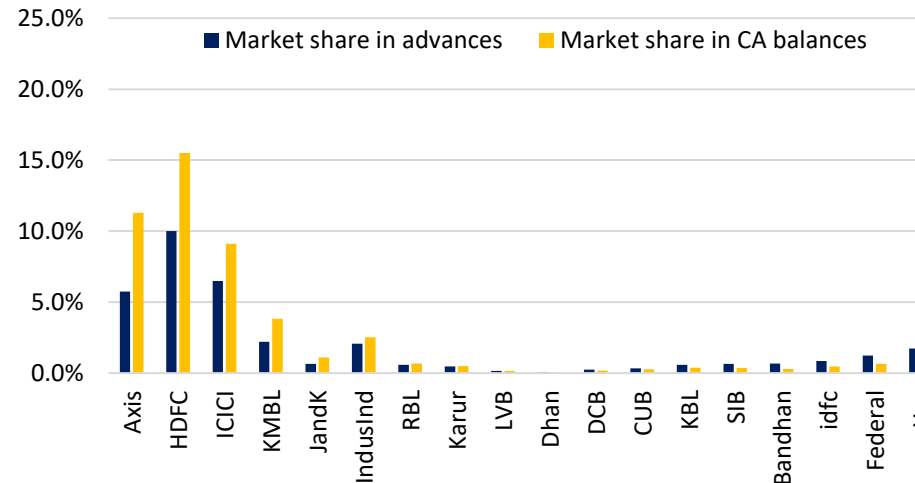


EXHIBIT 5: Some large PVBs have relatively higher share in CA vis a vis advance



Source: Banks, ICRA research.

Note, above data is sorted based on the difference in CA deposit share and advances market share. Estimates as on March 31, 2020.

Key points of the RBI Notification:

If a borrower already has a Cash Credit (CC) or an Overdraft (OD) facility, no bank can open a Current Account for such borrower

- The borrower would need to route all transactions through the CC/ OD account only. So, in a way, the CC/ OD account will double-up as both a loan account as well as a current account. The existing current accounts would need to be closed within a period of the next three months.
- In case any bank has a share of less than 10% of the banking system exposure on the borrower, credits are fully permitted in the CC/ OD account, but debits can only be for credit to the CC/ OD account maintained with any bank that has greater than 10% of the banking system exposure on the borrower.
- This would have the effect of ensuring that monies drawn from the CC/ OD limits availed from multiple banks are eventually channelled through a CC/ OD account -- thus enabling easier monitoring of the fund flows.

EXHIBIT 5: Criterion for opening current account if a borrower does not have any CC/ OD account

Scenario: When the banking system exposure on the borrower is	Stipulation on the opening of current accounts	ICRA's comments
> Rs. 50 Crore	<p>A current account akin to an escrow account can be opened by an escrow managing bank.</p> <p>Lending banks can open collection accounts with no restrictions on credits in such collection account and debits will be only to escrow account.</p> <p>Non-lending banks cannot open a current account.</p>	This would have the effect of enabling the lending banks specify a waterfall of payouts through the escrow mechanism -- thus supporting the serviceability of loans
> Rs. 5 Crore but < Rs. 50 Crore	<p>There are no restrictions on the lending banks to open current account.</p> <p>Non-lending banks can only open collection accounts (not current accounts)</p>	Such borrowers may have lending relationships with few banks. Hence flexibility of collection account with non-lending banks is unlikely to impact sales collections
< Rs. 5 Crore	Lending / Non-lending banks are free to open current accounts but need to take an undertaking from the entity that if its borrowings go beyond Rs. 5 Crore, it would inform the bank that has opened the current account and then governed by above two conditions	-
NIL	Banks are free to open current accounts	-

Source: RBI, ICRA Research

Further, banks are not allowed to route the drawal of term loans through current accounts. Since term loans are meant for specific purposes, the funds need to be remitted directly to the supplier of goods and services. This will also enable better tracking of funds by the lenders

Impact on Cost of funds:

EXHIBIT 6: Cost of funds could rise for banks if the CA deposits base declines

Increase in cost of deposits (bps)		Share of CA deposits in overall deposits		
% Decline in CA balances		10%	15%	20%
	5%	2.50	3.75	5.00
	10%	5.00	7.50	10.00
	15%	7.50	11.25	15.00
	20%	10.00	15.00	20.00
	25%	12.50	18.75	25.00
	30%	15.00	22.50	30.00

Source: RBI, ICRA Research.

Assuming the loss of CA deposits are replaced with other deposits at interest rate of 5%

Overall CA balances at system level could decline: There is a high likelihood that the overall CA balances for the banking system will decline in near-term as the CC/OD accounts become the key operative accounts for managing the day to day expenses and the existing CA balances will be transferred to the CC/OD accounts.

Credit and deposit growth will take a hit: This will also moderate the system wide deposit growth and credit growth number as the deposit balances in current accounts will be netted off against the credit outstanding in the CC/OD accounts. A rough calculation that for every 10% of such CA deposit balances (~Rs 11 trillion as on March 31, 2020) are netted off against the CC/OD accounts, then the credit outstanding will decline by 1.1% and deposit outstanding will decline by 0.8%.

Service charges could increase for the customers: As the banks will now find alternate avenues to recoup the possible loss of profit margins, they are likely to increase the service fee charged to customers for services like cash management services and other collection services.

Foreign banks have CA deposits driven by their global relationships: Foreign banks do have even higher share of CA deposits in their overall deposits as well higher market share of CA deposits as compared to their market share in credit, which could also impact their deposit base. However, based on observations of CA depositor profile of foreign banks in ICRA rated portfolio, we note that their CA deposits are more driven by corporates where these foreign banks have global relationships. Such customers also have limited borrowing from domestic sources. The impact on foreign banks hence will also be driven by their depositor profile the foreign banks.

Tight timelines for compliance: RBI has instructed banks to comply with the circular within three months of the notification. As there will be lot of coordination required among banks as well as borrower and lot of operational work atleast as a part of initial implementation, the time frame is quite tight.



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- Assist the regulators in promoting transparency in the financial markets;
- Provide intermediaries with a tool to improve efficiency in the funds raising process.

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