A Study on impact of regulatory issues on sensitive sectors lending of Indian Scheduled Commercial banks

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ABSTRACT

Commercial banks with their number of branches and subsidiaries work as a backbone of an economy. The activity of the Indian commercial banks today is not confined only to the traditional kind of banking like accepting deposits and lending loans. Indian banks have noticed exponential growth along with a paradigm shift in its regulatory framework. Reserve bank of India has stipulated norms and appropriate risk weights for banks in India. Bank exposure to certain areas needs to be carefully managed and monitored regularly given stability of the Indian financial system. The Study of credit allocation and sensitive sartorial distribution of bank credit provides an understanding of the contribution of the bank credit towards economic growth and financial inclusion as well as its role in maintaining financial stability. Three sectors viz., capital markets, real estates, and commodities have classified under the heading of the sensitive sector for banks. These sectors have been deemed to before the stability of the banks sensitive considering the often price fluctuations. Accordingly, banks' exposure to sensitive sectors presumes significance in the context of financial stability as these sectors are subject to frequent fluctuations in prices. This paper makes an empirical assessment of the sensitive lending sector of scheduled commercial banks using the data for two years i.e., 2016-17 and 2017-2018. The study reveal that the Real Estate sector proved to be one of the major contributors to total advances of sensitive lending sectors in both the years of study that is 2016-17 and 2017-18. The exposure of the banks to public sector banks and private sector banks has increased for both capital markets and real estate, but in the case of Foreign banks, there was an *increasing trend in the case of real estate and declining trend in case of capital markets. Among the bank groups, it is observed that the growth in credit flow from the public sector banks to the sensitive sectors stayed higher than the private sector banks and foreign banks,*

Keywords: Sensitive sectors lending, Regulatory issues, Scheduled Commercial Banks, Public sector banks, Private sector banks, and foreign banks, Capital market

INTRODUCTION

The economic growth of a country is functional to its banking system and financial services. Banks play a significant role in boosting the economy to a progressive stage. Banks, in general, is defined as an organization that accepts deposits and lends loans. Banks are acting as mobilizers to transfer the funds from savers to investors. In modern times the role of banks has changed tremendously, and the banking system has evolved as the heart of the economy. With the increase in the size of the banking system, there is a parallel increase in the lending sector in general and the sensitive lending sector in particular. Banks play an extremely significant role in economic development. Due to their size of operations and accumulated knowledge, banks can handle multiple tasks. Banks are exposed to financial and nonfinancial risks that are interdependent and if the situation is not handled well it quickly affects the bank's health. Thus, bank top management should give appropriate weight and importance to the ability to identify measure, monitor and control the overall level of risks faced by the banks. Banks' exposure limits to sensitive sectors thus necessarily need to be monitored and restricted when required.RBI has stipulated prudential limits on exposure to sensitive sectors. The RBI has been adopting a gradual approach to enhance transparency in the banking sector. Over a while, the set of disclosures has gradually been expanded to encompass important information including lending to sensitive sectors like capital market, Real Estate, and commodities. The gradual expansion of the range of disclosures standards in India at par with those prevalent internationally. In this context, an attempt has been made to expose the sensitive sectors in public sector banks, private sector banks and foreign banks.

OBJECTIVES OF THE STUDY

1. To study the regulatory framework concerning Bank Lending to the Sensitive Sectors
2. To study Share of Bank Group-wise to the Scheduled commercial banks(SCB) for the year 2016 -17 and 2017-18

3. To study a comparative study of Bank Lending to the Sensitive Sectors between the year 2016 17 and 2017 -18 and
4. To study Share of Bank Group-wise Lending to the Sensitive Sectors for the year 2016 - 17 and 2017-2108

RESEARCH METHODOLOGY

The study is based on secondary data collection. The source of information is Report on Trends and the progress of the banking sector, Reserve Bank of India. The reference period is for two years i.e. 2016-17 and 2017 -18. Data analysis tools used for the study are percentages and Comparative analysis

REVIEW OF LITERATURE

This section provides the review of the past studies conducted on the topic which helps to identify the research gap

Rajesh Desai (2017) viewed that Indian banks have noticed exponential growth along with a paradigm shift in its regulatory framework. To provide sufficient credit facilities to agricultural, SMEs, and other weaker, as well as important sections of society, the concept of priority sector lending (PSL), has evolved in the year 1967-68. Along with its positive results, PSL also contributes substantially to non-performing assets (NPAs) of banks. Lower profitability, lower value of a loan, defaulting borrowers, lower productivity of the agricultural sector, government interventions are some of the reasons why PSL is not much attractive for commercial banks. It is important to note that every sub-sector of the priority sector is not equally risky creating a need to study how different sectors contribute towards NPA. The study concludes that NPA in the priority sector is positively related to agricultural lending, industrial lending, and personal lending whereas service sector lending harms NPA. The results are statistically significant for industrial and service sector lending. The study enable the banks to devise better credit policies for sensitive sectors and help them to reduce credit exposure in those areas.

Brajapallav Pal & Saswatha Choudhary(2017) opined that commercial banks with its branches and subsidiaries work as the backbone of the economy of a country. The activity of commercial banks is not only confined to the traditional kind of banking like accepting deposits, lending loans, creating credit, etc. Globally, banks now stretched their activities towards various intermediaries and advisory services to the clients. Indian banks are also working in the same way. With its increasing sphere of activities, the risks of commercial banking are also increasing. One of the major risks in banking risk is concentration risk. The concentration of risk arises due to the concentration of credit extended by banks in a single entity or group of entities carrying on the same line of business. In India, there are certain regulatory measures issued by the Reserve Bank of India (RBI) for better asset management and safeguarding the banks from the concentration risks. In this study, an attempt has been made to study different risks associated with the banking business as well as the nature of financing by banks to the sensitive sectors in India. And it also has been tried in this study to examine the relationship between bank performance and lending concentration for the study 27 public sector banks were collected in India. The study reveals that the lending concentration has a significant relation with bank performance and it also has a significant impact on a bank's performance.

Deva Dutta Dubey and Pankaj Trivedi (2017) studied that Reserve Bank of India has stipulated the exposure norms risk weights for banks in India. Bank exposure to certain sectors needs to be carefully managed and monitored regularly given stability of the financial system. The study of credit allocation and sectoral or geographic distribution of bank credit provides an understanding of the contribution of bank credit towards economic growth and financial inclusion as well as its role in maintaining financial stability. Three sectors viz real estate, capital markets, and commodities have been classified under the head of ‘sensitive sectors’ for banks. These sectors have been deemed to be sensitive for the stability of banks considering the (often violent) price fluctuations in the underlying asset/product market. Accordingly, banks’ exposure to sensitive sectors presume significance in the context of financial stability as underlying assets in these sectors are subject to fluctuations in prices and as such leads to booms and advances. The present paper makes an empirical assessment of the additions to NPA in banks based on their exposure to sensitive sectors.

RESEARCH GAP

Based on the literature, very little research work is done in this area and most of the scholars have analyzed how sensitive sector lending affects the profitability of banks. Few researchers have studied the trend and outlook of banks towards sensitive sector lending and its effect on NPA. However, no one has tried to identify how individual sensitive sectors their share to total advances of sensitive sector lending, the share of bank group-wise of sensitive sector lending to scheduled commercial banks and share of individual sensitive sectors in public sector banks, private sector banks foreign banks and small scale finance. The present paper attempted in this direction to fill the research gap.

REGULATORY FRAMEWORK CONCERNING SENSITIVE SECTORS

In India, there are certain regulatory measures, taken by the Reserve Bank of India (RBI) for better asset management and safeguarding the banks from the concentration risk. To safeguard the Indian banks from the risks arising out of such credit concentration and for the better asset management, the Reserve Bank of India has identified three sectors, namely real estate, capital market, and commodity market, as the sensitive sectors for the financing and also issued some measures for financing towards these sectors. These sectors are sensitive because the volatility in these sectors can largely affect the asset quality of the banks

Reserve Bank of India has introduced the Exposure Norm for all Scheduled Commercial Banks (excluding the Regional Rural Banks) in India in Mid-Term Policy Review on August 20, 2002.In an undated note from RBI on Risk Management Framework in Banks, RBI has stated that banks and financial institutions play an extremely significant role in economic development. Due to their size of operations and accumulated knowledge, banks can handle multiple risk scenarios. Banks are exposed to various financial and non-financial risks that are interdependent and if the situation is not handled well, bank health problems can quickly transfer from one entity to another. Thus, bank top management should give appropriate weight and importance to the ability to identify measure, monitor and control the overall level of risks facing the bank. Banks should aim to back up exposures by adequate collaterals or strategic considerations. RBI has stipulated prudential limits on exposure to sensitive sectors.

In case of capital market exposure, the ceiling would cover (i) direct investment in equity shares and convertible bonds and debentures; (ii) advances against shares to individuals for investment in equity shares (including IPOs), bonds and debentures, units of equity-oriented mutual funds; and (iii) secured and unsecured advances to stockbrokers and guarantees issued on behalf of stockbrokers. Banks are expected to regularly report to its Board about exposures of a bank to stockbrokers and market-makers as a group, as also exposures to other sensitive sectors. The Reserve Bank has been adopting a gradual approach to enhanced transparency in banking organizations. Over a period of time, the set of disclosures has gradually been expanded to encompass important information including lending to sensitive sectors (viz., capital market, real estate, and commodities). The gradual expansion of the range of disclosures has been bringing the disclosure standards in India at par with those prevalent internationally. It is reported that the banks have similarly expanded their exposures every year and hence the RBI has been cautioning them

RBI Master circular Exposure Norms stipulated that banks should frame comprehensive prudential norms relating to the ceiling on the total amount of real estate and the policy should be approved by the banks' Boards. Prudential capital market exposure norms prescribed for banks were rationalized in terms of base and coverage. The revised guidelines, which came into effect from April 1, 2007, cover the bank's capital market exposure. Such exposures include both their direct exposures and indirect exposures. RBI, limits on Banks' Exposure to Capital Markets comprises a statutory limit on shareholding in companies as defined in the Banking Regulation Act, 1949 It also included the regulatory limit on the aggregate exposure of a bank to the capital markets in all forms (both fund-based and non-fund based). There are also caps on the bank's direct investment in shares, convertible bonds/debentures, units of equity-oriented mutual funds and all exposures to Venture Capital Funds (VCFs) [both registered and unregistered]. This paper looks at banks' exposure to sensitive sectors and their impact on the formation of NPA and thus its importance in the management of a portfolio of advances.

Banks continued to post robust growth in retail loans during 2017-18. Housing loans were supported by incentives for affordable housing such as the Pradhan Mantri AwasYojana (PMAY) and the implementation of the Real Estate (Regulation and Development) Act (RERA). Furthermore, rationalization of risk weights and provisioning on standard assets in certain categories of individual housing loans in June 2017 gave a fillip to the segment. Auto loan growth also edged. During H1:2018-19, retail loans continued to record robust growth driven by housing and auto loans and credit card receivables.

DATA ANALYSIS AND INTERPRETATION

Table 1
Share of Bank Group-wise Sensitive sector lending to the Scheduled commercial banks for the year 2016 -17

(Amount in ₹ billion)

Sector	Public Sector Banks	Private Sector Banks	Foreign Banks	Scheduled Commercial Banks
Capital Market	581.74 (45.78)	592.23(46.61)	96.63 (7.61)	1270.61 (100)
Real Estate	9969.03(61.03)	5347.85(32.74)	1018.18(6.23)	16335.06 (100)
Commodities	-	-	-	-
Total Advances to Sensitive Sectors	10550.77(59.93)	5940.08 (33.74)	1114.82 (6.33)	17605.67 (100)

Source: Report on Trends and Progress of Banking in India 2017 and 2018, RBI

Table 1 shows the composition of all segments included in the sensitive sector in public sector banks. The share of total advances to the sensitive sector at the end of March 2016-17 was 59.93 percent in the case of public sector banks, 33.74 percent in the case of private sector banks and only 6.33 percent in the case of foreign banks. It was observed individually that the contribution of the public sector is more in case of capital markets and whereas private sector banks contributed more to real estate. The public sector banks continued to account for about 60% of the total exposure of SCBs to sensitive sectors.

Table2 Share of Bank Group-wise Sensitive sector Lending to the Scheduled Commercial banks for the year 2017 -18					
(Amount in ₹ billion)					
Sector	**Public Sector Banks**	**Private Sector Banks**	**Foreign Banks**	**Small Finance Banks**	**Scheduled Commercial Banks**
Capital Market	592(42.29)	727(51.93)	81(5.78)	0.0	1400(100)
Real Estate	11152 (59.64)	6478(34.64)	1044 (5.58)	26 (0.14)	18700(100)
Commodities	-	-	-	-	-
Total Advances to Sensitive Sectors	11744 (58.43)	7205(35.84)	1125(5.60)	26 (0.13)	20100(100)

Source: Report on Trends and Progress of Banking in India 2017 and 2018, RBI

Table 2 indicates that in case of total advances to sensitive sectors, a major chunk of the lending i.e., 58.43 percent was contributed by public sector banks followed by the private sector banks. The total sensitive sector exposure of foreign banks was only 5.60 percent. When it comes to individual sector contribution, the real estate and capital markets constitute the largest segment of the sensitive sectors in case of public sector banks and private sector banks respectively

Table 3 A comparative study of Lending to the Sensitive Sectors between the year 2016 -17 and 2017 -18 in case public sector banks				
(Amount in ₹ billion)				
Sector	2016-17	2017-18	Change in absolute figures	percentage variation
Capital Market	582	592	10	1.72
Real Estate	9,969	11,152	1183	11.87
Commodities	-	-	-	-
Total Advances to Sensitive Sectors	10,551	11,744	1193	11.31

Source: Report on Trends and Progress of Banking in India 2017 and 2018

Table**3** depicts the descriptive statistics of data. It is evident from table that the credit to sensitive sectors—real estate and the capital market—increased in 2017-18, as a result, the total advances to sensitive sectors increased by Rs1193 billion i.e., by 11.31% as compared to the previous year. In the case of capital markets, there was a mild increase as compared to the previous year, and when it comes to real estate it was increased by 11.87 %, this may be due to some revival in housing sector activity. The public sector bank's proportion to their net credit has grown only marginally, by 1.72 % in March 2017-18 in the case of capital markets. In absolute terms, the exposure of public sector banks to this sector has gone up by only Rs 10 billion

Table 4
A comparative study of Lending to the Sensitive Sectors between the year 2016 -17 and 2017 -18 in case private sector banks

(Amount in ₹ billion)

Sector	2016-17	2017-18	Change in absolute figures	percentage variation
Capital Market	592	727	135	22.8
Real Estate	5,348	6,478	1130	21.13
Commodities	-	-	-	-
Total Advances to Sensitive Sectors	5,940	7,205	1265	21.3

Source: Report on Trends and Progress of Banking in India 2017 and 2018, RBI

The Reserve Bank of India's move to choke the flow of credit to sensitive sectors -- real estate and capital markets -- seems to have worked partly for private sector banks with the growth in the flow of credit to these segments dipping to increasing by 21.3 per cent during 20017-18 as compared to the previous financial year shown in table 4

Table 5
A comparative study of Lending to the Sensitive Sectors between the year 2016 -17 and 2017 -18 in case Foreign banks

(Amount in ₹ billion)

Sector	2016-17	2017-18	Change in absolute figures	percentage variation
Capital Market	97	81	-16	-16.49
Real Estate	1,018	1,044	26	2.55
Commodities	-	-		
Total Advances to Sensitive Sectors	1,115	1,125	10	0.9

Source: Report on Trends and Progress of Banking in India 2017 and 2018, RBI

Table 5 witnessed that thetotal sensitive sector exposure of foreign banks depicts that during the year 2017-18,banks' lending to sensitive sectors comprising of the capital market, was decreased by Rs 16 billioni.e., by 16.49 percent as compared to the previous year i.e., 2016-17. In the case of real estate, it increased to Rs 26 billion with a variation of a 2.55 percent increase as compared to 2016-17,

Table 6
Share of Bank Group-wise Lending to the Sensitive Sectors for the year 2016 -17

(Amount in ₹ billion)

Sector	Public Sector Banks	Private Sector Banks	Foreign Banks	Scheduled Commercial Banks
Capital Market	581.74 (5.51)	592.23(11.07)	96.63(8.67)	1270.61(7.23)
Real Estate	9969.03(94.49)	5347.85(90.03)	1018.18(91.33)	16335.06 (92.78)
Commodities	-	-		-
Total Advances to Sensitive Sectors	10550.77(100)	5940.08(100)	1114.82(100)	17605.67 (100)

Source: Report on Trends and Progress of Banking in India 2017 & 2018, RBI

The table 6 presents that the share of real estate is more than the capital market in all bank groups about SCBs. This reveals that there is more demand for the real estate sector. The public sector witnessed 94.49 percent, private sector banks 90.03 percent and foreign banks 91.33 percent. As an overall SCBs resulted with 92.78 percent in real estate

Table 7
Share of Bank Group-wise Lending to the Sensitive Sectors for the year 2017 -18

(Amount in ₹ billion)

Sector	Public Sector Banks	Private Sector Banks	Foreign Banks	Small Finance Banks	Scheduled Commercial Banks
Capital Market	592 (5.04)	727 (10.09)	81 (7.2)	0.0 (0)	1400(6.97)
Real Estate	11152(94.96)	6478(89.91)	1044 (92.8)	26 (100)	18700(93.03)
Commodities	-	-	-	-	-
Total Advances to Sensitive Sectors	11744(100)	7205 (100)	1125(100)	26 (100)	20100(100)

Source: Report on Trends and Progress of Banking in India 2017 &2018, RBI

The results from the table 7 indicates that for the year 2017-2018 , the share of real estate is more than the capital market in case of all the bank groups i.e., public sector banks, private sector banks, and foreign banks and as a result the scheduled commercial banks share was 6.97 percent in case of capital market contribution and the share of real estate contribution to total advances to sensitive sectors is 93.03 percent. If we observe the individual contribution of banks then the results reveal that capital market contribution is 5.04 percent and real estate contribution is 94.96 percent to total advances to sensitive sectors in the case of public sector banks. In the case of private sector banks, a capital market contribution is 10.09 percent and real estate contribution is 89.91 percent. When it comes to foreign banks the contribution of the capital market is 7.2 percent and real estate contribution is 92.8 percent. Real estate contribution is 100 percent and Capital market contribution is nil in case of small finance banks.

SUGGESTIONS

There are many irregularities in the sensitive sector market as reported in media from time to time and hence there is a need of caution in the banks while taking up the exposure in sensitive sectors. In other words, these sectors need to be kept under constant watch and to be adequately disclosed in the balance sheet of banks. Further ,RBI may conduct a concurrent research study on sensitive sector practices to mitigate the risk to the banking sector .To that, the loan approval process is not hampered on account of this, while the proposals could be sanctioned in the normal course, the disbursements should be made only after the borrower has obtained requisite clearances from the Government authorities.

CONCLUSION

The study found that in case of total advances to sensitive sectors a majority of the lending was contributed by public sector banks followed by the private sector banks in both the years of the study i.e., 2016-17 & 2017-18. The credit to sensitive sectors—real estate and the capital market—increased in 2017-18, as a result, the total advances to sensitive sectors increased as compared to the previous year in case of each public and private sector banks .Foreign banks' lending to sensitive sectors comprising of the capital market was decreased by Rs 16 billion by 16.49 percent as compared to the previous year i.e 2016-17. In the case of real estate, it increased to Rs 26 billion with a variation of a 2.55 percent increase as compared to 2016-17.

In the case of all the banks i.e., Public sector banks, Private sector banks and Foreign banks the share of real estate are more than the capital market in both the years of study i.e., 2016-17 & 2017-18. This reveals that there is more demand for the real estate sector. Among the bank groups, it is observed that the growth in credit flow from the public sector banks to the sensitive sectors stayed higher than the private sector banks and foreign banks,

SCOPE FOR FURTHER RESEARCH

More research can be carried out on the following areas

- A study can be conducted on to estimate the impact of exposure to sensitive sectors on NPA in Indian commercial banks
- A comparative study can be carried out on the risk management in sensitive sectors
- To investigate various types of risk involved in banks' lending to sensitive sectors

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