Corpsec Hotline

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RBI TO REGULATE BANK EXPOSURE TO NBFCS

In a bid to guard against diversion of bank funds to the stock market, the Reserve Bank of India (**RBI**) which is the central bank, is actively considering clamping down on the exposures banks have to non-banking finance companies (**NBFCs**) that do not accept deposits from the public.

The RBI 's concern follows the recent increase in the activities of such NBFCs and requests from a number of foreign and private sector banks to set up non-deposit taking NBFCs. Unlike deposit-taking NBFCs, where regulations have been tightened , there are virtually no regulatory guidelines governing NBFCs that do not accept deposits from the public. The RBI , is therefore, considering exercising some control over these NBFCs by stipulating limits on banks regarding the extent of their exposure to such NBFCs. Banks are currently not allowed to lend more than 5% of their advances as at the end of the previous financial year for stock market related activities. Most banks are understood to be well within these limits. However, it is feared their exposure to the capital market may be much higher through the NBFC route. Apart from loans, banks have been subscribing in a big way to commercial papers floated by NBFCs. The RBI is unlikely to wait till the mid-term review of its Annual Policy on October 25 for making public the new lending limit of the banks to NBFCs.

Earlier, RBI had expressed its concern over the issue that bank funds may be diverted to the capital markets, fuelling a rise in stock prices. The central bank is eager to end the practice of 'regulatory arbitrage' under which some banks are trying to take advantage of the looser regulatory norms governing NBFCs to engage in activities that are currently out of bounds to them.

-Mini Raman & Siddharth Shah
You can direct your queries or comments to the authors

Source: Financial Express dated 10th October 2005

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