

# News Update

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## RBI rules out NBFCs from priority sector lending

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## News Update

The purpose of emphasizing on priority sector lending for banks was channelizing lending to agriculture and weaker sections that would bring about financial inclusion. Investments by banks in securitised assets, representing loans to various categories of priority sector, on lending to NBFCs were made eligible for meeting these targets, but now it seems that the banks are using this channel to fund NBFCs and were misused.

This came under the scanner of the Finance Ministry, where it was seen that the banks were simply funding the NBFCs by buying their portfolios. In the master circular on Lending to Micro, Small and Medium Enterprises (MSME) sector, on 1<sup>st</sup> July, 2011<sup>1</sup>, Section II on *Certain types of funds deployment eligible as priority sector advances*, Clause 2.1.1 clearly states that –

### 2.1.1 Securitised Assets

Investments made by banks in securitised assets, representing loans to various categories of priority sector, shall be eligible for classification under respective categories of priority sector (direct or indirect) depending on the underlying assets, provided the securitised assets are originated by ***banks and eligible financial institutions*** and fulfill the Reserve Bank of India guidelines on securitisation.

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2.1.2 Outright purchases of any loan asset eligible to be categorised under priority sector, shall be eligible for classification under the respective categories of priority sector (direct or indirect), provided the loans purchased are eligible to be categorised under priority sector; the loan assets are purchased (after due diligence and at fair value) from ***banks and eligible financial institutions***, without any recourse to the seller; and the eligible loan assets are not disposed of, other than by way of repayment, within a period of six months from the date of purchase.

The circular clearly excludes NBFCs in the priority sector categorization. Similar provisions have been mentioned in the master circular on priority sector lending on 5<sup>th</sup> July, 2011<sup>2</sup> (Para II on Other Important Features of the Guideline, (i) and (ii)). Since financial institutions cannot be taken to be NBFCs, RBI has been very clear in its intent on keeping NBFCs away from priority sector.

<sup>1</sup> RBI/2011-12/83 RPCD.SME & NFS. BC. No. 09/06.02.31/ 2011-12,  
<http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=6553&Mode=0>

<sup>2</sup> <http://rbidocs.rbi.org.in/rdocs/Content/PDFs/107ANNO050711.pdf>

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Further the master circular mentions that any loan sanctioned to NBFCs w.e.f 1<sup>st</sup> April, 2011 for on lending, against gold jewelry, investment made by banks in securitized assets originated by NBFCs where the underlying assets are loan where the underlying assets are loans against gold jewelry and purchase/ assignment of gold loan portfolio from NBFCs would not be eligible for priority sector lending.

NBFCs have been playing a complimentary role to the banks so far and have been integral to the financial sector. RBI has clearly put NBFCs away from the priority sector lending scene and this circular comes as a big blow to the growth of the sector.