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AFTER THE STORM: THE HINDU EDITORIAL ON TIGHTENING SCRUTINY OF LARGE NBFCS

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The RBI has proposed a significant shift in its regulatory approach towards India's non-banking financial companies (NBFCs), from a general approach of light touch regulation to one that monitors larger players almost as closely as it does banks. If implemented, this could be the biggest overhaul of the regulatory framework for such finance companies (or shadow banks) in over two decades. After multitudes of investors were left high and dry as CRB group firms reneged on high-interest fixed deposits in 1997, Parliament bestowed greater powers over such firms to the central bank to fix the mess. The trigger now is similar though the scale of the problem has changed. The size of NBFC balance sheets is now more than a quarter of that of banks' balance sheets, from just about 12% in 2010. In absolute terms, their balance sheets have more than doubled, from 20.7-lakh crore in 2015 to 49.2-lakh crore in 2020. While this growth is a reflection of how lighter regulations have given them the flexibility to meet a range of financing needs, from home loans to micro-finance and large infrastructure projects, it also manifested into a systemic risk. And that risk was apparent when one of the largest infrastructure investment-focused NBFC players, IL&FS, unravelled in 2018, with its payment defaults catalysing a crisis for the entire sector. The collateral damage meant NBFCs could not raise funds easily, and faced liquidity pressures that escalated to solvency concerns in some instances.

The descent of one such player, Dewan Housing Finance Corporation Limited (DHFL), began around the same time — its creditors approved a resolution plan for the firm last week. The RBI's proposed regulatory reaction to such large NBFC failures that have had a systemic impact on the sector, could not have come sooner. It has sought to strike a balance between the need to be nimble and mitigate systemic risks, with a four-tiered regulatory structure. This entails a largely *laissez-faire* approach for smaller NBFCs, plugging some of the arbitrages available to mid-sized NBFCs *vis-à-vis* banks, and imposing tougher 'bank-like' capitalisation, governance and monitoring norms for the largest players and those which could pose a systemic risk due to the nature of their operations. A top tier has been envisaged with even more scrutiny, but the RBI wants to ideally use this approach only when a certain large player poses 'extreme risks'. Given the banking sector's own woes over the past two years (PMC Bank, Yes Bank, Lakshmi Vilas Bank), a holistic reboot of the oversight mechanism for NBFCs and banks is critical to retain confidence and maintain financial stability which central bank Governor Shaktikanta Das has termed a 'public good'. It is hoped that the blueprint for the regulation of NBFCs which can lend for activities banks often do not support, be it micro-loans or infrastructure projects, is formalised soon. This would ensure the fledgling economic recovery is not hampered by funding constraints.

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