

# Banks mull self-regulatory mechanism to prevent diversion of loans

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Such diversion is one of the main reasons for the burgeoning of bad loans in the country



## Mumbai, June 22:

In a bid to put a stop to the malpractice of loan diversion, banks are considering putting in place a self-regulatory mechanism whereby they will allow a prospective borrower to open a current account only if the lender with whom the borrower is currently banking gives the green signal to do so.

Diversion of loans, especially routing of funds through a bank other than the original lender bank/members of consortium without its/their prior permission, has emerged as one of the main reasons why some of the large assets have turned sour for banks in the country.

“The practice of borrowers opening current accounts with other banks without obtaining clearance from the bank/ banks with whom they are currently banking with is clearly detrimental to the health of the banking system. “The time has now come for establishing a self-regulatory mechanism whereby obtaining permission of the current lender/consortium of lenders should become a must to ensure that wayward borrowers don’t divert funds,” said a senior public sector banker clued in to deliberations on this front.

Last year, the then director of the Central Bureau of Investigation Anil Sinha sought better monitoring of end-use of funds by banks, especially of large-value accounts to detect possible diversion of funds.

Reserve Bank of India (RBI) defines diversion of funds as utilisation of short-term working capital funds for long-term purposes not in conformity with the terms of sanction; deploying borrowed funds for purposes/activities other than those for which the loan was sanctioned; and transferring borrowed funds to subsidiaries/group companies or other corporates by whatever modalities.

Further, routing of funds through any bank other than the lender bank or members of consortium without prior permission of the lender; and investment in other companies by way of acquiring equities/debt instruments without approval of lenders also fall under the ambit of loan diversion.

Under the self-regulatory mechanism that banks are seeking to put in place for borrowers to whom they have an exposure of Rs. 5 crore or more, either singly or through a consortium, each bank will appoint a nodal officer, who will be responsible for giving/declining requests made by other banks regarding opening a current account of a borrower of his bank.

Besides, a bank looking to open a current account of a prospective borrower has to run a check through the RBI’s Central Repository of Information on Large Credits (CRILC) to determine which other banks this borrower is currently availing facilities from.

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