Note on Co-Lending Model

Table of Contents

1. **Introduction:**

Reserve Bank of India (RBI) had issued guidelines on **Co-origination of loans by Banks and NBFCs for lending to Priority Sector** vide Circular FIDD.CO. Plan. BC.No.08/04.09.01/2018-19 dated 21/09/2018**.** The arrangement entailed joint contribution of credit at the facility level by both the lenders as also sharing of risks9z and rewards.

RBI later issued fresh guidelines on **Co-Lending by Banks and NBFCs to Priority Sector** vide circular FIDD. CO. Plan. BC.No.8/04.09.01/2020-21 dated 05/11/2020, superseding its earlier Co-origination circular mentioned above. As per these guidelines, the primary focus of the revised scheme is to improve the flow of credit to the unserved and underserved sectors of the economy and make available funds to the ultimate beneficiary at an affordable cost, considering the lower cost of funds from banks and greater reach of NBFCs. Under the new scheme christened as "Co- Lending Model" (CLM), banks are permitted to co-lend with all registered NBFCs (including HFCs) based on a prior agreement.

This policy is for entering into Co- lending arrangement for all Asset Products (both priority and non-priority) with NBFCs, under guidelines stipulated by RBI from time to time.

2. **Background:**

Under the Co-lending arrangement, bank is permitted to co-lend with all registered NBFCs (including HFCs) based on a prior agreement. A loan will be partially booked in Bank's balance sheet with the balance share in co-lending partner (CLP) books. NBFCs shall be required to retain a minimum of 20 per cent share of the individual loans on their books.

3. **Objective/ Advantages of Co-Lending for the Bank:**

   a. **Acquisition scale up**: The partnership will enable the Bank to utilize the distribution strength and local knowledge of the Co-Lending partner for acquiring customers. NBFCs can originate fresh loans as per a prior master agreement with the Bank.

   b. **Achieving Priority Sector Lending**: Higher proportion of loans being funded under the Co-Lending Model will be qualifying for priority sector lending (PSL) as defined by the extant RBI guidelines. The co-lending of loans will enable the Bank to meet the PSL requirements by sharing risks and rewards with the CLPs.

   c. **Lower Operating costs:** CLPs will be responsible for origination, servicing and collection of loans originated under the CLM. The model will be low-cost operating model, thereby improving the overall profitability.

4. **Essential Features of Co-Lending Model:**

   a. Execution model: A Master Agreement should be entered into between the Bank and NBFC for implementing the CLM and should provide Bank the discretion to reject loans subject to Bank's due diligence, prior to taking it into its books.

   b. Master Agreement: A Master Agreement is to be entered between the Bank and NBFC, which shall inter-alia include, terms and conditions of the arrangement, the criteria for selection of partner NBFC, the specific product lines and areas of operation, along with provisions related to segregation of responsibilities as well as customer interface and protection issues.

   c. Know Your Customer (KYC) and AML norms: Bank shall comply with the Master Directions – Know Your Customer (KYC) Direction, 2016, updated from time to time, permitting regulated entities (RE), at their option, to rely on customer due diligence done by a third party subject to specified conditions. In this connection, KYC done by NBFCs can be accepted in line with RBI guidelines.

d. Bank shall not be allowed to enter into co-lending arrangement with an NBFC belonging to the promoter group.

e. Grievance redressal: It will be the responsibility of the NBFCs to disclose and explain to the end borrower the details of the arrangement upfront and their explicit consent taken in the co-lending model. NBFC shall be primarily responsible for customer service and grievance redressal to the borrower. Suitable arrangements shall be put in place by the bank and NBFC in the Master Agreement to resolve any complaint registered by a borrower with the NBFC within 30 days, failing which, the borrower shall have the option to escalate the same with concerned Banking Ombudsman/ Ombudsman for NBFCs or the Customer Education and Protection Cell (CEPC) in RBI.

5. Customer related issues:

a. The NBFC or CLP shall be the single point of interface for the customers and shall enter into a loan agreement with the borrower, which shall clearly contain the features of the arrangement and the roles and responsibilities of the NBFCs and the bank.

b. The ultimate borrower may be charged an all-inclusive interest rate as may be agreed upon by both the lenders conforming to the extant guidelines applicable to both.

c. The extant guidelines relating to customer service and fair practices code and the obligations enjoined upon the bank and NBFCs or CLP therein shall be applicable in respect of loans given under the arrangement.

d. The NBFC or CLP should be able to generate a single unified statement of the customer, through appropriate information sharing arrangements with the bank.

6. Other Operational Aspects:

a. The co-lending bank and NBFCs shall maintain each individual borrower's account for their respective exposures. However, all transactions (disbursements/ repayments) between the bank and NBFCs relating to CLM shall be routed through an escrow account maintained with the banks, in order to avoid inter-mingling of funds. The Master Agreement shall clearly specify the manner of appropriation between the co-lenders.

b. The Master Agreement may contain necessary clauses on representations and warranties which the originating NBFC shall be liable for in respect of the share of the loans taken into its books by the bank.

c. The bank should take adequate safeguards on the escrow arrangement, security & recourse related documents (Pledge, Hypothecation, Mortgage, Guarantee etc.) including in the event of insolvency proceedings under IBC of a co-lending partner. It is recommended that the legal ownership of the escrow account should be with the bank.

d. The co-lenders shall establish a framework for monitoring and recovery of the loan, as mutually agreed upon. The co-lenders shall arrange for creation of security and charge as per mutually agreeable terms, wherever applicable.

e. The master agreement between the Bank and co-lending partner should clearly specify that if there is a difference of opinion between the bank and the co-lending partner on resolution of a loan account, then the bank view should prevail and the bank should be able to access all relevant documents to enforce security.

f. The master agreement with the CLP should give the bank at any time, at its sole discretion, the right to step-in to the shoes of the CLP and takeover the collection from any individual borrower, a set of borrowers or all borrowers.

g. The Master Agreement should capture that the CLP will not introduce a borrower into the arrangement, who already has an existing loan with the CLP or its associate entities directly or under a co-lending arrangement, without prior disclosure to the bank.

h. Each lender shall adhere to the asset classification and provisioning requirement, as per the respective regulatory guidelines applicable to each of them including reporting to Credit Information Companies, under the applicable regulations for its share of the loan account. Recognition of NPAs will be done as per RBI guidelines as applicable to respective co-lenders.

i. Both the bank and the NBFCs shall implement a business continuity plan to ensure uninterrupted service to their borrowers till repayment of the loans under the co-lending agreement, in the event of termination of co-lending arrangement between the co-lenders.

j. Area of Operation and Credit Risk: Co-lending of loans with NBFCs may be restricted generally to their domain of expertise. The same is to be incorporated in Master Agreement.

k. Internal Audit: The loans under CLM shall be included in the scope of Internal/statutory audit within the Bank and NBFC to ensure adherence to their respective internal guidelines, terms of the agreement, extant regulatory requirements and additional requirements from Govt. of India in case of loan accounts becoming eligible for interest subvention etc., if any. Therefore, Bank's extant RFIA & Statutory Audit guidelines will be made applicable to all loans under co-lending model.

l. Assignment: Assignment of loans to third party will be done only with the mutual consent of Bank and NBFC

m. IT Enablers & Data sharing: The CLP shall ensure sharing of data in a seamless manner on the following points subject to customer consent and data privacy:
    i. Underwriting of files
    ii. Disbursement
    iii. MIS related to disbursement, repayments, portfolio created & all incidental activities related to the same

n. Any modification to this arrangements should have the approval of the Group President – Risk, Group President of Bank and Head – Legal.

7. Selection of CLPs:

a) **Due Diligence** - Before putting up the proposal for on-boarding, due diligence of the NBFC will be conducted on the following parameters invariably:

i. Understanding of the business model, segment of operation.
ii. Origination, underwriting process including deviation structure
iii. Collection and recovery process, NPA recognition norms.
iv. Storage of documents and security thereof

The following parameter of the NBFC or CLP should be reviewed:

Parameter
External Credit Rating (ECR)
Assets under Management
Net worth
Total Outside Liabilities/Net Owned Funds
Gross NPA/ Stage 3 Book
Capital Adequacy ratio (CAR)
Default track record of NBFC with lenders
Experience of NBFC inmanaging Asset Portfolios

Note: In the event of downgrading in ECR of the NBFC or CLP, the co-lending arrangement with the NBFC will be reviewed.

b) **Arrangement with a Co-Lending partner** - Sign up any new Co-Lending Partner needs to be approved by Level G of Credit Committee of the Bank or by any authority as delegated by the Level G of Credit Committee.

8. Review:

a) Annual review - Annual review of the arrangement with every NBFC/CLP will be conducted
b) Portfolio review – Portfolio created under the Co-Lending Model with every CLP should be periodically reviewed and actions, if any, should be taken accordingly.

9. Exposure Limit

The cumulative total limit for the bank for funding under the Co-I-ending arrangement with all the partners will be capped to Rs.2,500 Crs. Exposure under Co-I-ending arrangements above the cumulative limit of Rs.2,500 Crs will need the approval of the Board.

10. An abridged version of the Co-Lending Policy will be placed on the Banks website.

RBI circular on Co Lending 5th Nov 20

RBI circular on Co origination of Loan