

Non-banking Financial Companies

**Draft proposals on co-lending to
broaden scope and increase
transparency; significant changes
likely for existing arrangements**

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CLM-1 model of co-lending is expressly permitted under the proposed framework; CLM-2 is not covered

Interest rates charged to the borrowers could witness some reduction as it shall be based on the blended interest rates of the lending partners

Uniform DLG cap of 5% of loan outstanding to be introduced for all CLAs



- On April 9, 2025, the RBI¹ came out with a draft framework for co-lending and sourcing arrangements to cover a wide-ranging variety of arrangements among REs², which were not expressly covered in the past. The draft framework also offered enhanced coverage of all asset segments vis-à-vis only PSL³ in the past. This draft framework gains prominence given that the size of co-lending transactions have been witnessing robust growth over the past few years.

- The CLM-1⁴ model of co-lending is expressly permitted under the proposed framework, as each single loan shall be shared among the funding REs right from the first disbursement. This shall be carried out on the basis of a non-discretionary ex-ante Inter-Creditor Agreement with joint nature of rights. However, there is no specific reference to 'CLM-2'⁵ in the draft framework; further clarification on the same is awaited.

- It is also proposed that interest rates shall be arrived at as a blended interest rate, calculated as an average of the interest rates charged by respective funding partners, weighted by their proportionate funding share. If the same is implemented, borrowers could see some reduction in interest rates from the prevalent levels.

- Existing CLM regulations are applicable only for Bank–NBFC⁶ arrangements for PSL loans, with NBFCs being responsible for client interfacing and servicing activities. However, in recent years, many NBFCs also have started entering into arrangements with other smaller peers. These are similar to CLM arrangements and may include some forms of CE⁷/ DLG⁸ as well. Incrementally, under the proposed framework, DLGs shall be uniformly restricted to 5% of the loans outstanding. Further, no implicit guarantees or absorption of credit losses via adjustments to servicing charges is permitted. This would restrict unanticipated losses for the originating RE the sourcing/servicing partners.

- Incrementally, the reporting requirements under the CLA⁹ are also set to increase. Details regarding the partners and interest rates shall be disclosed on the websites of the lenders. Further, quarterly disclosures on the quantum and performance of such transactions shall also be provided. Overall, ICRA expects a significant improvement in transparency in the co-lending space, going forward.

1 – Reserve Bank of India; 2 – Regulated entities 3 – Priority sector lending; 4 – 'Co-Lending Model-1' (Defined subsequently in the note) ; 5 – 'Co-Lending Model-2' (Defined subsequently in the note); 6 – Non-banking financial companies; 7 – Credit Enhancements; 8 – Default loss guarantee; 9– Co-lending arrangement

Co-lending arrangements increasingly seen as a supplementary funding source by M&S NBFCs*



Over the past few years, co-lending has emerged as a key funding source for M&S NBFCs, enabled by the rapid improvement in IT systems and integration between entities. This has especially been led by various fintechs, in segments such as personal loans, consumption loans and small business loans.

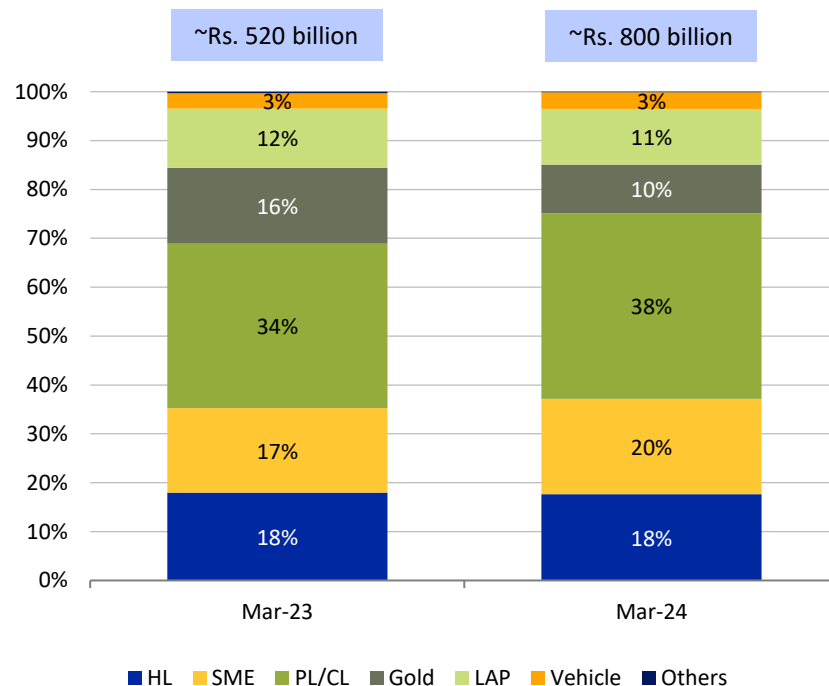
Current regulations for co-lending do not cover the entire gamut of lending and sourcing arrangements, especially NBFC-to-NBFC arrangements, and neither do they cover non-PSL funding.



As per current regulations, co-lending arrangements follow two models, viz., 'CLM-1' and 'CLM-2'.

Under CLM-1, while the NBFC is in charge of sourcing, both the bank and NBFC simultaneously fund the individual loan accounts based on a pre-agreed proportion. Under CLM-2, the NBFC sources and disburses the loan to the individual accounts, followed by the bank reimbursing the pre-agreed proportion to the NBFC in lieu of the loan assets. In case the bank exercises discretion regarding the above, the transaction is treated akin to a direct assignment (DA) transaction, though the same is exempt from the applicable MHP®.

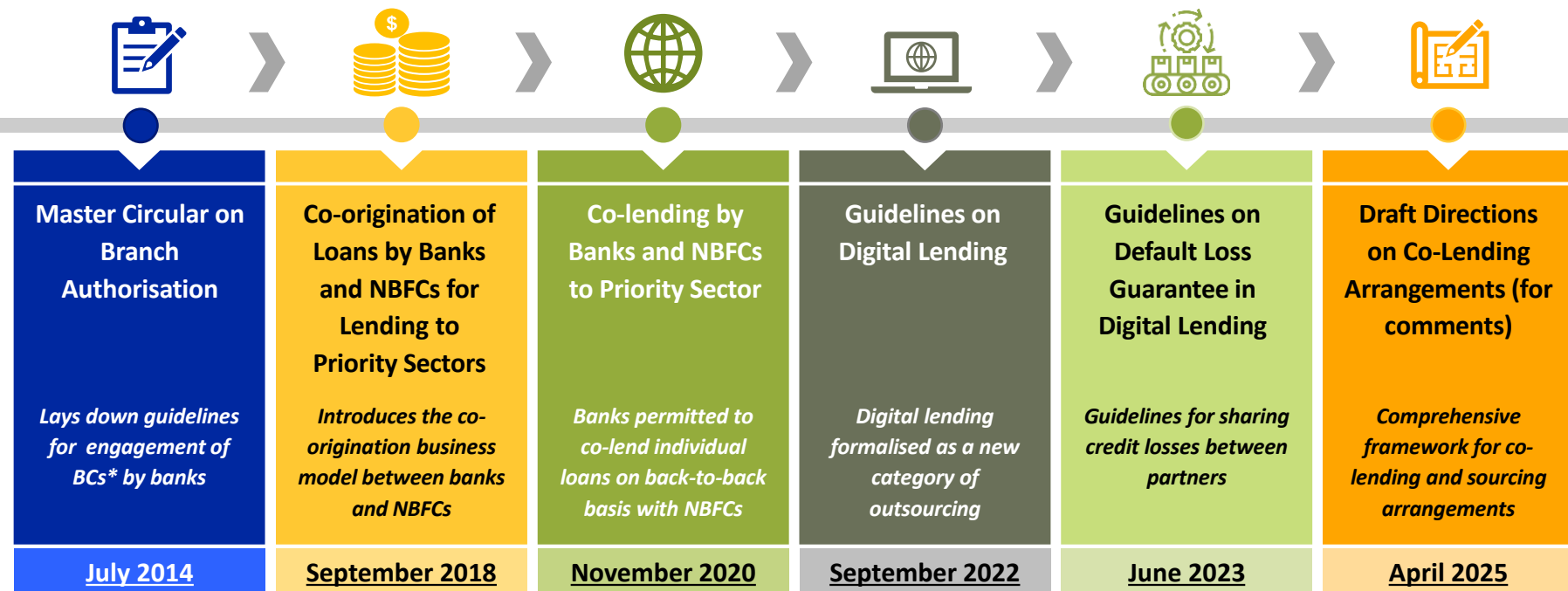
EXHIBIT: Co-lending AUM# of M&S NBFCs



Source: RBI, ICRA Research; Co-lending data is based on ICRA's sample set entities for assessing the co-lending book; #AUM- Assets under management; *M&S NBFC – Medium & small non-banking financial companies with AUM of up to Rs. 150 billion; HL – Housing loans; SME – Loans to small & medium enterprises; PL/CL – Personal loans/Consumption loans; Gold – Gold loans; Vehicle – Vehicle loans; LAP – Loan against properties; @MHP – Minimum Holding Period

Timeline of regulatory developments

Over a period, the RBI has refined the regulatory contours for third-party sourcing and co-lending business arrangements; while the draft directions, when enforced, shall provide an overarching framework for such arrangements, respective regulations shall also continue to be applicable.

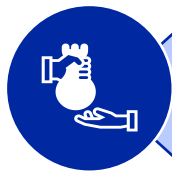


Source: RBI, ICRA Research; *BC – Business correspondents

Comprehensive scope of proposed framework to provide clarity and guidance on permitted arrangements

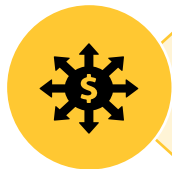
All categories of sourcing and co-lending arrangements, with certain exceptions, are covered under the draft directions; this would significantly increase clarity for REs and re-shape the way such arrangements currently operate

EXHIBIT: Types of arrangements under the draft directions



Sourcing arrangements

An arrangement wherein an RE or a non-RE sources a loan (sourcing entity), in compliance with extant guidelines, for another RE (funding entity) on a fee basis, i.e., without any reference to a profit-sharing agreement, with the exposure being entirely booked by the funding entity, ab-initio.



Co-lending arrangements

An arrangement, formalised through an ex-ante legal agreement, among the permitted REs to jointly fund a loan portfolio in a pre-agreed proportion, involving revenue and risk sharing with or without sourcing and management arrangements.



Exceptions

- Engagement of BCs by banks, loan participation transactions, P2P* lending shall continue to be guided by respective regulations
- Digital lending arrangements involving co-lending shall, in addition to this draft framework, also be governed by the Digital Lending Guidelines, dated September 2022.

Proposed Co-lending Model

Each loan under the arrangement shall be shared among the funding REs right from the first disbursement. This shall be executed on the basis of a non-discretionary ex-ante inter-creditor Agreement with joint rights, i.e., CLM-1. All transactions (disbursements/ repayments) between the REs, as well as with the borrower, shall be routed through an escrow account.

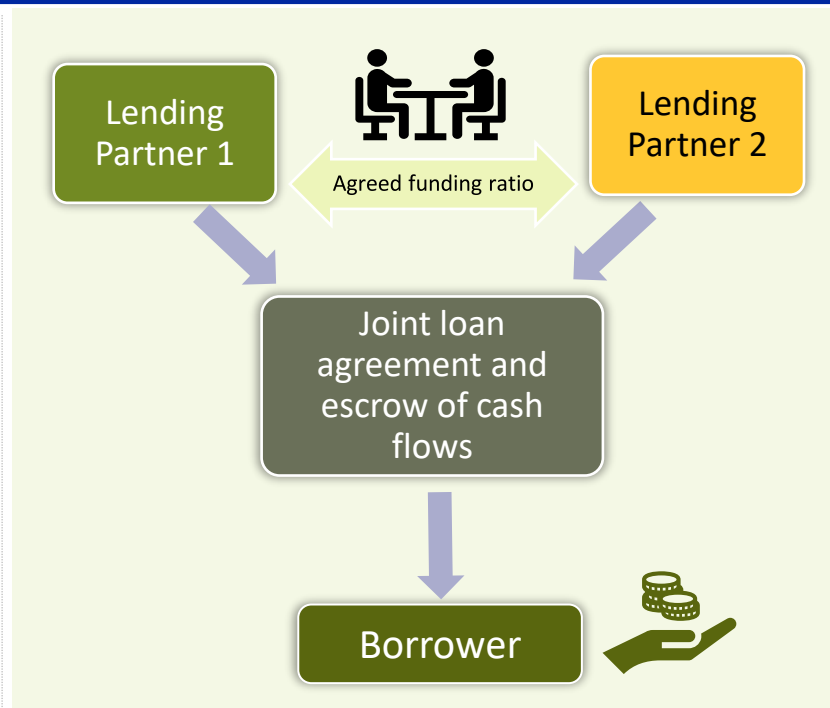
CLM-2, which involves back-to-back arrangements after origination and is akin to a DA transaction, is not specifically mentioned in the draft framework.

The minimum share of funding to be retained by the sourcing partner has not been specified under the proposed framework; this shall be decided by the partners themselves, providing significant flexibility on the structuring of CLAs.

Under the existing CLM, the sourcing partners, i.e., NBFCs would have to retain a minimum share of 20% of the individual loans on their books.

The current co-lending regulations between banks and NBFCs (for PSL loans) do not permit DLGs. However, many NBFC-NBFC arrangements are prevalent, with cases where there are CE/DLG/loss compensation agreements. Implicit guarantees with servicing charges adjusted against credit losses are also observed.

As per the proposed framework, co-lending/ sourcing arrangements may include DLGs, which can be provided by permitted REs, up to 5% of loans outstanding. Implicit guarantees via servicing arrangements are not permitted. DLGs in any form by other REs or non-REs shall not be permitted.



Borrowers to benefit from introduction of 'blended interest rates'

As per the existing practice, borrowers are charged an all-inclusive interest rate as agreed upon by the lending partners.

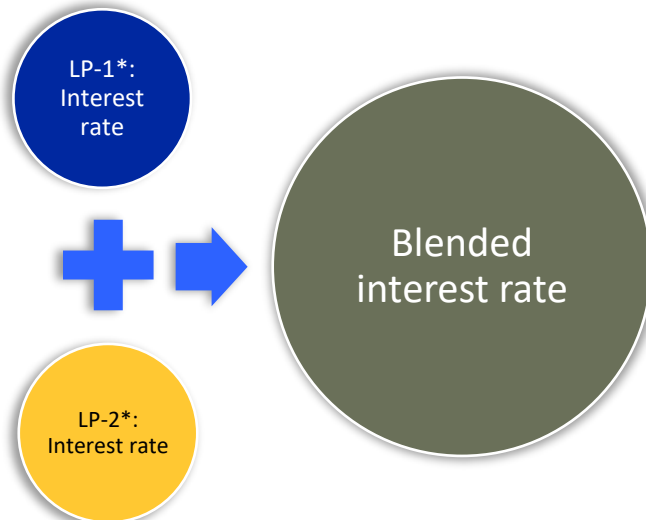
However, the draft directions propose to shift to a blended interest rate, which is calculated as an average rate of interest derived from the interest rates charged by respective funding REs, weighted by their proportionate funding shares.

No Ad-hoc Charges:

The interest rate and all other fees and charges shall be based on a contractual agreement

Sourcing/ Servicing :

Fee/charges payable to the sourcing or servicing entity shall be a separate arrangement and not included in the blended interest rate



Example

80:20 loan sharing	LP-1	LP-2
Base rate	8%	14%
Risk premium	2%	3%
Interest rate to customer	10%	17%
Blended interest rate	11.4%	
APR# in KFS@	11.4% + Other fees / charges	

Blended interest rate under the proposed directions 11.4%

Interest rate charged to customer as per existing practice 17%

Source: RBI, ICRA Research; *LP-1 – Lending Partner-1; LP-2 – Lending Partner-2; #APR – Annual Percentage Rate; @KFS – Key Fact Statement



Current Regulation/ Practices

Loan sourcing and servicing: Under the current Bank–NBFC CLM regulations for PSL loans, the NBFC shall be the single interface for the customer. It shall enter into a loan agreement with the borrower, containing the features of the arrangements, and delineate the roles and responsibilities of both partners, i.e., the bank and the NBFC.

The existing guidelines for customer service and the fair practices code, along with the obligations for banks and NBFCs, will apply to loans given under this arrangement. All details of the arrangement must be disclosed to customers upfront, and their explicit consent must be obtained. Further, the NBFC should also be able to generate a single unified statement of the customer, through appropriate information sharing arrangements with the bank.



Proposed Regulation

The agreement among the CLA partners shall decide the partner responsible for customer interfacing, providing significant flexibility in structuring the arrangements. Loan agreements signed by borrowers with both funding REs shall make upfront disclosures regarding the segregation of roles and responsibilities (such as sourcing, funding, and servicing) of concerned partners, including the entity being customer interface. Any subsequent change in customer interface shall only be done after taking explicit consent from the borrower. The loan agreement shall also appropriately disclose suitable provisions related to customer protection and grievance redress mechanisms. The regulatory guidelines on business conduct and customer service applicable for the lender with the larger funding share, will also apply to the partner lenders.

The proposed directions envisage standardising the sourcing and servicing arrangements:

- REs may engage an RE or a non-RE to source and/or service the loans in compliance with relevant outsourcing guidelines.
- The nature, purpose, extent of the facility and all required standards of performance should be clearly specified in a written agreement. The sourcing/servicing facility is provided on an 'arm's length' basis, on market linked terms and conditions.
- Payment of any fees/charges for sourcing/servicing shall not be subject to deferral or waiver in a way that would directly or indirectly provide credit enhancement or liquidity facility.
- There should not be any recourse to the entity sourcing/servicing the loans beyond the fixed contractual obligations. Further, the servicing entity shall be under no obligation to remit funds to the RE(s) until it has received funds generated from the underlying loans.

These proposed measures, while increasing the flexibility of the partners in segregating their roles and responsibilities, shall bring in more transparency and protection for customers.



Asset Classification



Current regulation

As per the current practice, asset classification is handled separately by both the lending partners in co-lending arrangements. This could result in situations where a loan to a single borrower is recognised as a standard account by one of the partners and as an SMA/NPA* by the other partner.



Proposed framework

Under the proposed co-lending arrangements, asset classification by the REs shall be applicable at the borrower level. This implies that if any of the REs classifies their exposure as SMA/NPA*, the same classification shall be applicable to the exposure of other REs as well.



Reporting and Disclosures

Currently, banks and NBFCs have to formulate board-approved policies for entering CLMs and place the same on their websites. Under the digital lending guidelines, entities follow enhanced disclosure requirements, including details of partnerships on their websites. CIC reporting is also followed diligently, as required.

Additionally, the following disclosures have to be made on the websites of REs:

- List of CLA partners for various arrangements
- Indicative range of blended interest rates and fees/charges charged to the borrowers under different CLAs

Further, the following quarterly disclosures have to be made in the notes to accounts of REs:

- Weighted average RoI[#], fees charged/paid, sectors under CLA, performance of loans under CLA, details related to DLG, etc.



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