Non-banking Financial Companies

Tighter operational requirements and lower returns for originator likely to impact volumes even as new co-lending guidelines widen scope

AUGUST 2025

Highlights

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Retention requirements lowered to 10% for each RE from previously 20% for originating RE.

Reduction in interest rate charges for borrowers likely, based on the blended interest rates of the lending partners.

CLM-2 allowed with conditions; partner RE's share of loans to be transferred within 15 days of disbursement.

5% DLG is now permitted for co-lending transactions.

- On August 06, 2025, the RBI[1] came out with final directions for co-lending arrangements to cover a wide-ranging variety of arrangements prevailing among eligible REs[2], which were not expressly covered in the past. These norms, effective from January 01, 2026, to cover all unsecured and secured asset segments vis-à-vis only PSL[3] assets in the past. Further, minimum on-book retention requirements has been lowered to 10% for participating REs from previously 20% for originating RE.
- Under the new directions, borrowers are to be charged a blended interest, calculated as an average of the interest rates charged by respective funding partners, weighted by their proportionate funding share. Consequently, borrowers could witness some reduction in interest rates from the prevalent levels. Returns for the originating RE, however, would be impacted vis-a-vis existing levels.
- In the past directions, the NBFCs[4] were responsible for borrower interfacing and servicing activities. The final directions provide flexibility for one of the partners to take up the borrower interfacing on mutual consent. Further, in the past, escrow was required only for transactions between the co-lending partners; however, in the final directions all transactions between the REs as well as the borrowers have to be routed through an escrow account with clear agreement on appropriation of funds between the REs.
- The CLM-2[5] model of co-lending is permitted with conditions in the final directions. The arrangement requires an irrevocable commitment on the part of the partner RE to take into its books, on a back-to-back basis, its share of the individual loans as originated by the originating RE within 15 days of the date of disbursement. In case this does not happen, then it shall remain in the books of the originating RE and can be transferred via a direct assignment (DA) transaction to the partner RE or any other RE. However, MHP[6] relaxation for a DA transaction, which was permitted under the past norms, in case the partner RE exhibited discretion in taking over of loans, has not been covered in the final directions.
- The DLGs[7] of 5% on the loan outstanding is now permitted under the final directions, governed under the Digital Lending Directions (MD-DLD; 2025). The impact of providing DLG and accounting treatment for the unrealised gains from the deal on the originating partner's capital would emerge as key financial considerations, apart from the expected lower earnings on account of the blended rate. This, along with the tighter timeline for transfer of portfolio share to the partner RE and the escrow mechanism requirement, shall make the overall process onerous, in ICRA's view.

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

Co-lending arrangements increasingly seen as a supplementary funding source by NBFCs

Over the past few years, co-lending has emerged as a key funding source for NBFCs, especially small and medium scale 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.

Previous regulations for co-lending did not cover the entire gamut of lending arrangements, especially NBFC-to-NBFC arrangements, and neither did they cover non-PSL assets.

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

Under CLM-1, while the NBFC was in charge of sourcing, both the bank and the NBFC simultaneously funded the individual loan accounts based on a pre-agreed proportion. Under CLM-2, the NBFC sourced and disbursed the loan to the individual accounts, followed by the bank reimbursing the pre-agreed proportion to the NBFC in lieu of the loan assets.

Source: RBI, ICRA Research; CLM-1 – Co-Lending Model-1

Timeline of regulatory developments

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Over a seven-year period, the RBI has refined the regulatory contours for third-party sourcing and co-lending business arrangements; directions on co-lending arrangements shall provide an overarching framework for such arrangements, even as respective regulations shall continue to be applicable.

September 2018	November 2020	September 2022	June 2023	April 2025	August 2025
Co-origination of Loans by Banks and NBFCs for Lending to Priority Sectors	**Co-lending by Banks and NBFCs to Priority Sector**	**Guidelines on Digital Lending**	**Guidelines on Default Loss Guarantee in Digital Lending**	**Draft Directions on Co-Lending Arrangements**	**Final Directions on Co-Lending Arrangements**
Introduces the co-origination business model between banks and NBFCs	*Banks permitted to co-lend individual loans on back-to-back basis with NBFCs*	*Digital lending formalised as a new category of outsourcing*	*Guidelines for sharing credit losses between partners*	*Comprehensive framework for co-lending arrangements (for comments)*	*Comprehensive framework for co-lending arrangements*

Source: RBI, ICRA Research

Scope of directions expanded to cover all loans and across various eligible REs

01

Applicability/Eligible REs: Applicable to commercial banks (excluding small finance banks, local area banks and regional rural banks), all-India financial institutions, and non-banking financial companies (including housing finance companies).

Loans covered: Secured as well as unsecured (vis-à-vis only PSL covered under previous directions); further, digital lending arrangement involving co-lending by the REs shall, without exemption from to the MD-DLD (2025), be guided by the provisions of the co-lending directions.

02

Date of applicability: The new directions shall come into force from January 1, 2026, or from any earlier date as decided by an RE as per its internal policy ("effective date"). Any new arrangements entered into after the effective date shall be in compliance with the new directions. Existing arrangements (i.e., the lending arrangements executed before the date of issuance of these Directions) and new ones entered into prior to the effective date, shall be in compliance with the extant regulations.

03

Exclusions: The revised directions shall not apply to loans sanctioned under multiple banking, consortium lending, or syndication.

Source: RBI, ICRA Research

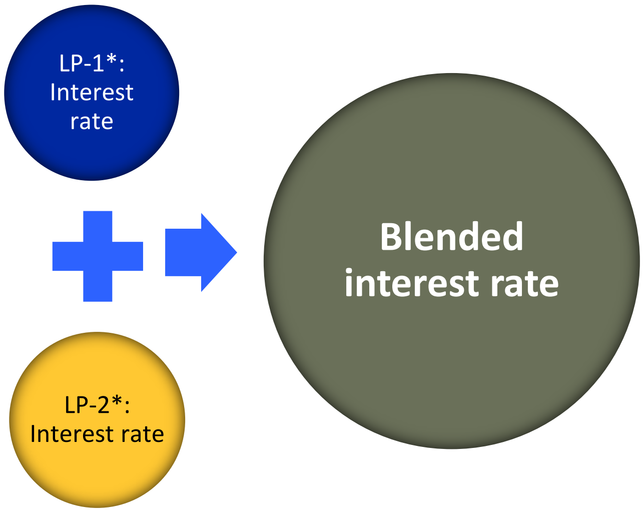
Borrowers to benefit from introduction of 'blended interest rates'

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

However, a blended interest rate is to be charged under new directions, 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

Additional Charges:
Any fees / charges payable by the borrower in addition to the blended interest rate shall be incorporated in computation of APR and included in the KFS



Example

90:10 loan sharing	LP-1	LP-2
Base rate	8%	14%
Risk premium	2%	3%
Interest rate to customer	10%	17%
Blended interest rate	10.7%	
APR# in KFS@	10.7% + Other fees / charges	

Blended interest rate under the revised directions	10.7%
Interest rate charged to customer as per existing practice	17%

As per the existing practice, the excess interest spread (EIS), i.e., difference between partner RE's interest rate and interest rate charged to the borrower, was typically appropriated by the originating RE, resulting in higher overall returns for them. **Under the new directions, the requirement of a blended interest rate would restrict the EIS available to the originating RE, thereby impacting overall returns vis-a-vis existing levels for them.**

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

CLM-2 allowed with some conditions

Final Co-lending Model

Previous directions: Under CLM-2, the NBFC sourced and disbursed 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 exercised discretion regarding the above, the transaction was treated akin to a direct assignment (DA) transaction, though the same was exempt from the applicable MHP.

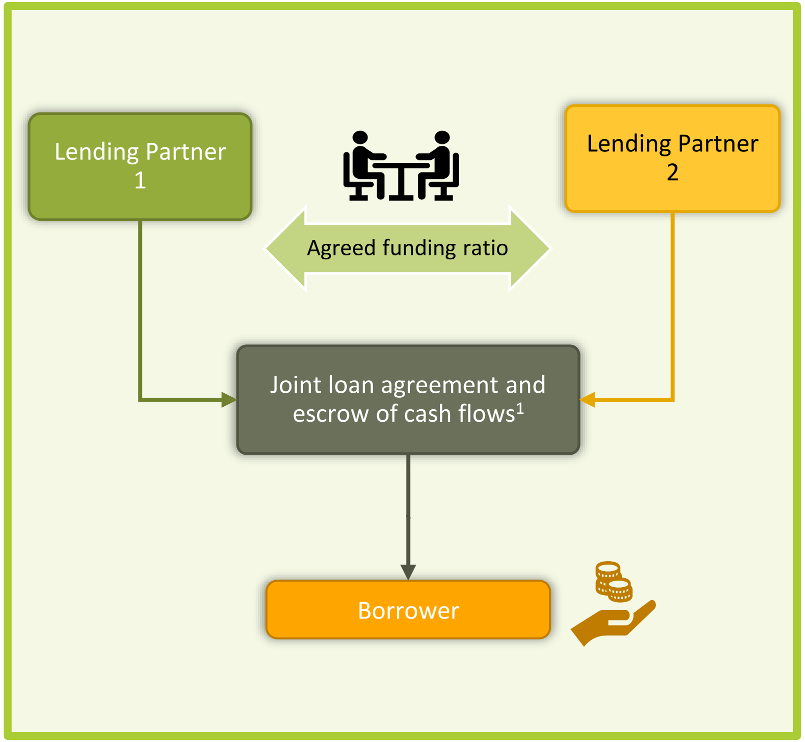
Draft directions: CLM-2 was disallowed as per the draft directions and each single loan under the arrangement was to be shared among the funding REs right from the time of the first disbursement.

Revised directions: The arrangement to be based on an irrevocable commitment on the part of partner RE to take into its books, on a back-to-back basis, its share of the individual loans from the originating RE within 15 days of the date of disbursement. In case this does not happen, then it shall remain in the books of the originating RE and can be transferred as a DA transaction. However, MHP relaxation for a DA transaction in case the partner RE exhibited discretion in taking over of loans, has not been covered in the final directions.

The minimum share of funding to be retained by the sourcing and funding RE has been specified as minimum 10% each from previously 20% (November 2020) for originating RE.

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

As per the final framework, co-lending may include DLGs up to 5% of loans outstanding. Provision of such default loss guarantee to be governed mutatis mutandis in terms of the MD-DLD as amended from time to time.



CE- Credit enhancement; [1]Participating REs may simultaneously fund the escrow account for disbursal or alternatively the originating partner may seek reimbursement from the other partner post disbursal; Source: RBI, ICRA Research

Improved borrower servicing flexibility in final regulations

Past Regulation/ Practices (November 2020)

Under the past Bank–NBFC CLM regulations for PSL loans, the NBFC was the single interface for the borrower and was required to enter into a loan agreement, clearly containing the features of the co-lending arrangement and the roles and responsibilities of the NBFCs and banks.

All details of the arrangement were to be disclosed to customers upfront, and their explicit consent was to be obtained.

Guidelines relating to customer service and fair practices code and the obligations of the banks and the NBFCs therein were applicable mutatis mutandis in respect of loans given under the arrangement.

The NBFC generated a single unified statement of the borrower, through appropriate information-sharing arrangements with the bank.

Grievance redressal mechanism was to be put in place by the co-lenders, with NBFCs to resolve the same within 30 days, failing which the borrower would have the option to escalate the same with the concerned banking ombudsman/ombudsman for the NBFCs or the Customer Education and Protection Cell (CEPC) in the RBI.

Revised Regulation (August 2025)

The agreement among the partners shall decide the RE (originating or partner RE) responsible for borrower interfacing, providing flexibility in structuring the arrangements.

Loan agreements signed by borrowers shall make upfront disclosures regarding the segregation of roles and responsibilities of concerned partners, including the entity being borrower interface. Any subsequent change in customer interface shall only be done with prior intimation to the borrower.

The loan agreement shall also appropriately disclose suitable provisions related to customer protection and grievance redress mechanisms.

The above is relatively relaxed in comparison to draft guidelines (April 2025), in which the borrower loan agreement was to be signed with both the funding REs; Any change in the borrower interface could happen only after explicit consent of the borrower.

Tighter operational requirements in the final regulations

Past Regulation/ Practices (November 2020)

The co-lending banks and NBFCs would have to maintain each individual borrower's account for their respective exposures.

All transactions (disbursements/ repayments) **between the banks and the NBFCs relating to the CLM were to be routed through an escrow account** maintained with the banks, in order to avoid inter-mingling of funds. In practice, disbursement / repayments have been from / into the NBFC's bank account, which in turn were routed from / to the escrow account maintained jointly by the bank and the NBFC. The Master Agreement would have to clearly specify the manner of appropriation between the co-lending partners.

The loans under the CLM were to be included in the scope of internal/statutory audit within the banks and the NBFCs to ensure adherence to their respective internal guidelines, terms of the agreement and extant regulatory requirements.

Both the banks and the NBFCs were to 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

Any assignment of a loan by a co-lender to a third party could be done only with the consent of the other lender.

Revised Regulation (August 2025)

Each RE shall maintain a borrower's account individually for its respective share. All transactions (disbursements / repayments) between **the REs, as well as with the borrower**, shall be routed through an escrow account maintained with a bank (which could also be one of the REs involved in co-lending). The agreement shall clearly specify the manner of appropriation between the originating and partner RE.

The loans under the co-lending arrangement shall be included in the scope of internal/ statutory audit in each RE to ensure adherence to their respective internal guidelines, terms of the agreement and applicable regulatory requirements.

REs shall implement a business continuity plan to ensure uninterrupted service to their borrowers till repayment of the loans, in the event of termination of the arrangement between the REs.

Any subsequent transfer of loan exposures originated to third parties, or any *inter-se* transfer of such loan exposures between REs, **shall be strictly in compliance with the provisions of Master Directions – Transfer of Loan Exposure (MD-TLE; 2021)**. Such transfers to a third party, however, can be done only with the mutual consent of both the originating and partner REs.

Clarity on reporting of asset classification; enhanced disclosure requirements

	Asset Classification	Reporting and Disclosures	Treatment
Past Regulation (Nov 2020)	As per the prevailing 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.	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.	Not covered
Revised Regulation (Aug 2025)	Under the revised directions, 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. REs shall put in place a mechanism for sharing relevant information in this regard on a near-real time basis, and in any case latest by end of the next working day.	Additionally, the following disclosures have to be made on the websites of REs: ▪ List of CLA partners for various arrangements Further, the following quarterly/annual 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.	The NBFCs shall adhere to the applicable accounting standards, while booking of unrealised profit under the CLAs, if applicable. However, such profits, shall be deducted from CET 1 capital or net owned funds for meeting regulatory capital adequacy requirement till the maturity of such loans. Further, the DLG amount shall also be deducted from CET 1 capital or net owned funds, as specified in MD-DLD (2025).

*Source: ICRA Research; * SMA – Special Mention Account; NPA – Non-Performing Asset; CLA – Co-lending arrangement; #RoI – Rate of interest; CET 1– Common equity Tier 1*

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Thank You!