**COUNTRY MANAGEMENT TEAM**

# CO-LENDING MODEL

## INTRODUCTION

RBI had issued guidelines to co-originate the loans with non-banking financial corporations (NBFCs) to enable banks meet PSL targets vide circular reference RBI/2020-21 / 63, FIDD.CO.Plan.BC.08/04.09.01/2020-21 dated November 05, 2020.

**The key highlights of the guidelines are as follows:**

The key features of the model are:

- Banks are permitted to co-lend with all registered NBFCs (including HFCs) based on a prior arrangement. The co-lending banks will take their share of the individual loans on a back-to-back basis in their books. NBFCs shall be required to retain minimum 20% of the share of their individual loans on their books.

- The loan will be partially booked in Bank's balance sheet [pre-agreed %] with balance share in co-lending partner (CLP's) books.

- The partner institutions may enter into a Master Agreement highlighting the terms and conditions of the arrangement and other parameters mentioned in the circular.

- The bank shall be required to comply with the Master Directions - Know Your Customer (KYC) Direction, 2016, issued vide RBI/DBR/2015-16/18 Master Direction DBR.AML.BC.No.81/14.01.001/2015-16 dated February 25, 2016 and updated from time to time, which already permit regulated entities, at their option, to rely on customer due diligence done by a third party, subject to specified conditions.

- The NBFC shall be the single point of interface for the customer, shall generate a single unified statement and shall enter into a loan agreement with the borrower, which shall clearly contain the features of the arrangement.

- The banks can claim priority sector status in respect of their share of credit.

## AUTHORITY REQUEST

The Country Management Team is requested to approve the appended note and approve the arrangement for the bank to co-lend assets with various NBFCs across its CPBB (Consumer, Private and Business Banking) offerings which qualify for priority sector lending (PSL) – MSME, Agri and home loans. This policy shall be reviewed every two years or earlier if there is any material change in the regulatory guidelines.

**Proposed by:**

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January 06, 2021

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January 06, 2021

**Background:**

Co-lending is an arrangement by which a loan will be partially booked in Bank's balance sheet [pre-agreed %] with balance share in co-lending partner (CLP's) books. The transactions would be governed by the guidelines issued by RBI to vide circular reference RBI/2020-21 / 63, FIDD.CO.Plan.BC.08/04.09.01/2020-21 dated November 05, 2020.

Objectives/Advantages of co-lending for the bank:

- Acquisition Scale up: It will enable the Bank to utilize the distribution strength and local knowledge of the CLP for originating loans. It will help bank meet the specific objectives of growing certain business in certain cities (Wherever SCB is present), segment, industries etc.
- Achieving priority sector requirement: All the sourcing would be PSL in nature and thus these transactions would help grow PSL assets.
- Low operating cost: It will be a low-cost operating model (Higher profitability) as CLP will be responsible for origination, servicing and repayment/collection of loans.

Under this arrangement, the bank proposes to co-lend PSL assets with various NBFC's

**Scope:**

Products:

- The bank proposes to co-lend assets with various NBFC's across its CPBB (Consumer, Private and Business Banking) offerings which qualify for priority sector lending– MSME (Business Loans, Guaranteed instalment loans, Loan against property, Business Working Capital, Agri facilities and home loans.
- The tenor, ticket size would be as per the existing organic norms. In-case of any changes they would be part of the approved policy note for the transaction which would be approved by the relevant stakeholders.

Areas of operation

- The same would be done for locations wherever SCB has branch presence

Partners:

- Existing FI clients would be potential partners. The existing FI clients are chosen after a thorough assessment basis their portfolio quality, portfolio size, credit rating and other factors basis the FI onboarding policy. Also, the factors are outlined in the Direct assignment DOI too.
- Further any new partners (currently not FI clients) would be on-boarded only after seeking an approval from the FI team.

**Details:**

Execution model:

There are two execution approaches (as laid down in the circular):

- If the bank can exercise its discretion regarding taking into its books the loans originated by NBFC as per the Agreement, the arrangement will be akin to a direct assignment transaction MHP norms will not be applicable in that scenario subject to compliance with all other conditions stipulated in RBI's guidelines for direct assignment - Model 1.

- If the Agreement entails a prior, irrevocable commitment on the part of the bank to take into its books its share of the individual loans as originated by the NBFC, the arrangement must comply with the extant guidelines on Managing Risks and Code of Conduct in Outsourcing of Financial Services by Banks issued vide RBI/2014-15/497/DBR.No.BP.BC.76/21.04.158/2014-15 dated March 11, 2015 and updated from time to time. In particular, the partner bank and NBFC shall have to put in place suitable mechanisms for ex-ante due diligence by the bank as the credit sanction process cannot be outsourced. The Banks does credit sanctioning and due diligence of the co-lent file pre-disbursals - Model 2.

SCB proposes to execute the co-lending model basis model 1. This will be set out in the Master Agreement with the CLP. The below details out the key aspects of the transactions for the same.

Direct assignment approach (Model 1)

| Description | Details |
|---|---|
| Sourcing to disbursal | Co-lending partner to source (NBFC/HFC) and disburse the cases |
| Credit Due diligence by bank | Bank will do 100% due diligence of all files as per the direct assignment norms to select the portfolio to be on-boarded. This would be done monthly or at a longer frequency too basis the arrangement<br>• Onboarded portfolio review<br>• Bureau review<br>• Name screening<br>• Dedupe<br>• PSL determination |
| KYC | In line with the direct assignment norms, Bank would rely on the customer due diligence done by the third party who would be a Non-Banking Financial Corporation (NBFC)/Housing Finance Company (HFC) regulated and supervised entity based out of India. As part of the due diligence, Bank would review the KYC policy of the NBFC to ensure that it is in line with extant regulations and Group requirements. The record retention and retrieval requirements would be documented in the Master Agreement |
| Transaction | Bank would pick up their share (Max of 80%) post the above due diligence and the requisite approvals as per the approved direct assignment process |
| Account creation | Loan to be set up in RLS (Bank) as well as in the CLP system for their respective exposures<br>Repayments from customers would be credited into the repayment Escrow account and the EMI would be split in the ratio of risk sharing. The repayments would be adjusted in RLS basis the same. This is in line with the existing process followed in direct assignments<br>An MIS would be maintained for all clients and shared by CLP<br>Rel ID is created for each underlying borrower as per BAU mechanism<br>Security and charge would be created by the NBFC as per mutually agreeable terms |
| Servicing | CLP would be responsible for the servicing of the loan. A service agreement would be signed too detailing the reps and warranties |

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| Archival | CLP to hold KYC & other relevant documents relating to the customer due diligence requirements and shall be made available to SCB upon request without delay. |
| Collection | CLP will be responsible for collection and recovery of the underlying loans.<br>SCB will have regular calls with the CLP to discuss the performance of the portfolio created through co-lending model |
| Grievance Redressal | Customer service and grievance redressal is with CLP. If NBFC fails to resolve customer grievance within 30 days, customer can escalate the same with the concerned Banking Ombudsman/Ombudsman for NBFCs or the Customer Education and Protection Cell (CEPC) in RBI. The necessary clauses would be part of MOU. NBFC would be responsible for client statement<br>SCB will receive regular MIS from CLP for customer queries / grievance highlighting the queries received, nature of queries, status and resolution |
| Regulatory and NPA reporting | Bank will adhere to the asset classification and provisioning requirement, as per regulatory guidelines, for its share of the loan account. Bank will do the necessary NPA reporting for its own share on loans disbursed under co-lending model |
| Portfolio Review | Portfolio created under Co lending model (CLM) will be reviewed on quarterly basis with the CLPs/ within the bank and corrective measures (if any) will be taken. |
| Renewal/Termination of Agreement | Basis on the portfolio and CLP review, the agreement will be renewed or terminated. Master Agreement will capture the details.<br>Business Continuity Plan is being set-up for adverse scenarios to ensure uninterrupted service to end borrowers. |

The loans under the CLM shall be included in the scope of internal/statutory audit to ensure adherence to internal guidelines, terms of the agreement and extant regulatory requirements.

**Implementation:**

Towards any specific proposal, the below steps will be completed pre-launch.

| Description | Details |
|---|---|
| Master Agreement | A Master agreement will be signed between the bank and CLP which will capture the deed of assignment and various other terms and conditions of the arrangement / reps and warranties of the arrangement and other parameters mentioned in the circular. It will have the back to back basis clause which will enable the MHP exemption<br>The respective legal teams would be finalizing the above format in consultation with the relevant stakeholders |
| Credit | Requisite due diligence/review of the NBFC credit criterion and detailed due diligence of the portfolio |
| KYC | Review of the KYC policy of the co-lending partner (CLP), |
| Process DOI | The existing DA process note would be used with revisions if any |
| Collection account | Escrow accounts/Collection accounts would be opened in line with the regulation. Any agreement required for the same would be finalized by legal accordingly |
| Pricing/ Commercials (Deal rate) | Would be finalized for every deal separately and would be part of the master agreement |

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| Client Documentation | The client documentation for the loans under this arrangement would carry necessary clauses towards acceptance of this arrangement |
| Tracking | Unique RLS product code would be created to identify the arrangement along with performance tracking and monitoring |
| Servicing | The client servicing would be done by the servicer i.e. originator. The same would be part of the servicer agreement signed by the client. |
| Post Disbursal | Service issues, collections and portfolio tracking reviews would be done at pre-set frequency<br>Requisite portfolio information would be shared by the originator |