POLICY ON
CO-LENDING MODEL (CLM)

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Credit Department -CPMG
The South Indian Bank Ltd
Head Office – Thrissur

Policy on Co-Lending Model (CLM)

Introduction

RBI has released guidelines on Co-lending by banks and NBFCs to Priority Sector vide circular RBI/2020-21/63FIDD.CO. Plan.BC.No.8/04.09.01/2020-21 dated 05.11.2020. As per guidelines, banks shall formulate Board approved policies for entering in to Co-Lending Model (CLM) and place the approved policies in the website. Accordingly, Policy on Co-lending by banks and NBFCs to Priority Sector has been framed. This policy supersedes bank's Policy on Co-Origination of Loans by Bank and NBFCs for Lending to Priority Sector.

Co-lending is joint contribution of credit/loans by Bank and NBFC at facility level with sharing of risk and reward.

The Co-lending model (CLM) is to improve the flow of credit to the unserved and underserved sector of the economy and make available funds to the ultimate beneficiary at an affordable cost, considering the lower cost of funds from the banks and greater reach of the NBFCs.

General Guidelines

- In terms of CLM, banks are permitted to co-lend with all Registered NBFCs (including HFCs) based on prior agreement. The bank will take their share of the individual loans on a back-to-back basis in their books. However, NBFCs should retain a minimum 20 % share of the individual loans in their books.
- Based on the CLM policy, banks may enter into master agreement with the eligible NBFC, including terms and conditions of the arrangement, criteria for selection of partner institutions, specific product lines and areas of operation, provisions related to segregation of responsibilities, customer interface, protection issues etc.
- The master agreement may provide for banks to either mandatorily take bank's share of the individual loans originated by the NBFCs in bank's books as per the terms of the agreement, or to retain the discretion to reject certain loans after bank's due diligence prior to taking into bank's books.
- Bank can claim priority sector status in respect of bank's share of credit under CLM adhering to extant norms related priory sector lending issued by RBI/Govt of India.

Eligibility Criteria for selection of partner institutions

The NBFC shall meet the following eligibility criteria to consider for the Co-Lending arrangement:

a) All Registered NBFCs (including HFCs) are eligible to be considered under CLM

b) The arrangement shall be only for the creation of priority sector assets.

c) The NBFC should have a Board approved policy for tie ups with banks for co-lending

d) Minimum CRAR of NBFC as per latest AFS should be 15%, with minimum Tier 1 capital of 10%.

e) Bank is not allowed to enter into co-lending arrangement with an NBFC belonging to the promoter Group.

f) NBFCs with satisfactory external rating of A and above shall be considered under this arrangement. NBFCs with satisfactory external rating of BBB and above may be considered for Gold Loan.

g) The NBFC shall have minimum lending experience of 3 years in the sector/portfolio/industry from where the loans are considered for Co-lending.

h) Net NPA percentage as per the latest AFS should be less than 3%.

Co-lending Model /arrangement sanction

- ☑ HO-CC1 is empowered to approve Co-lending arrangements with those NBFCs meeting the eligibility criteria. Asset quality, monitoring, collection & recovery mechanisms, underwriting quality of the NBFCs shall be considered while approving the agreement/arrangement.
- ☑ While approving the arrangement, the sanctioning authority shall fix the exposure ceiling for the loans sanctioned under the respective arrangement and also specify the maximum stress permissible in the portfolio/arrangement.
- ☑ Non Disclosure Agreement,Co lending master agreement and Standard Operating Procedure shall be signed by respective Vertical Heads.

Sanction of individual loans under CLM

Sanctioning of individual loans shall be done as per the approved scheme & agreement with NBFCs agreed as per the Master Agreement between bank and NBFC.
Bank may explore tie-ups with NBFCs to improve the flow of credit to the unserved and underserved sector of the economy including MFI/MSME lending. NBFCs' technological advantage and dominance in reach may be helping them to cater the demand of such segments.Fixing common criteria in the form of experience, rating etc may prevent bank in exploring tie ups with such NBFCs.To capitalize the opportunity by tie up with NBFCs with innovating technology, digital models, strong innovating business model etc., Management Committee of theBoard (MCB) may relax the eligibility conditions on a case to case basis.

Features and Scope of the Co-lending model

1. **General features**

The Master Agreement entered into by the banks and NBFCs for implementing the CLM may provide either for the bank to mandatorily take bank's share of the individual loans as originated by the NBFC in its books or retain the discretion to reject certain loans subject to its due diligence.

a. 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 under the extant guidelines.

b. Bank shall also 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.

c. If the bank can exercise its discretion regarding taking into its books the loan originated by NBFC as per the Agreement, the arrangement will be akin to direct assignment transaction. Accordingly, the bank shall ensure compliance with all the requirements in terms of Guidelines on Transactions Involving Transfer of Assets through Direct Assignment of Cash Flows and the Underlying Securities issued vide *RBI/DOR/2021-22/85DOR.STR.REC.53/21.04.177/2021-22 September24,2021* , as updated from time to time, with the exception of Minimum Holding Period (MHP) which shall not be applicable in such transactions undertaken in terms of this CLM.

d. The MHP exemption shall be available only in cases where the prior agreement between the banks and NBFCs contains a back-to-back basis clause and complies with all other conditions stipulated in the guidelines for direct assignment.

Customer service and related aspects	a. The NBFC 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 andresponsibilities of NBFCs and banks. b. All the details of the arrangement shall be disclosed to the customers upfront and their explicit consent shall be taken. c. 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. d. The extant guidelines relating to customer service and fair practices code and the obligations enjoined upon the banks and NBFCs therein shall be applicable *mutatis mutandis* in respect of loans given under the arrangement. e. The NBFC should be able to generate a single unified statement of the customer, through appropriate information sharing arrangements with the bank. f. With regard to grievance redressal, suitable arrangement must be put in place by the co-lenders to resolve any complaint registered by a borrower with the NBFC within 30 days, failing which the borrower would have the option to escalate the same with the concerned Banking Ombudsman/Ombudsman for NBFCs or the Customer Education and Protection Cell (CEPC) in RBI.

Other operational Aspects	
Borrower accounts& escrow mechanism	The co-lending banks and NBFCs shall maintain each individual borrower's account for their respective exposures. However, all transactions (disbursements/ repayments) between the banks and NBFCs relating to CLM shall be routed through an escrow account maintained with the banks, in order to avoid inter-mingling of funds.
Segment and loan ticket size	Sanctioning authority of the CLM may decide on the segment and areas where co-lending arrangement can be made by ensuring that the loans under this arrangement falls under Priority sector. Maximum ticket size of loans under co-lending model also may be decided based on the segment, area of operation and credentials of the co-lending partner.
Interest rate	Bank shall price our part of the exposure, in a manner found fit as per our respective risk appetite/ assessment of the borrower and the RBI regulations issued from time to time. 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.
Documentation	The loan agreement shall be either bipartite or tripartite in nature depending upon method mutually agreed between South Indian Bank and the NBFC in the Master Agreement.The loan agreement shall clearly contain the features of the co lending arrangement and roles and responsibilities of Bank and NBFC. Documentation process, execution, preservation of executed documents, making the same available to the internal auditors etc., shall be as per the terms of the agreement. Formats of documents/ loan agreements to be developed in co-ordination with the Legal Departments of the bank and NBFC. The documentation formats shall be the part of the agreement between the bank and NBFC. Responsibilities for execution of documents,bearing of loss on account of fake documents/title deeds/forgery/documentation faults shall also be covered in the agreement.
Security creation	The co-lenders shall arrange for creation of security and charge as permutually agreeable terms. Creation of security and charge shall be completed as per mutually agreeable terms of the agreement. Necessary clauses & arrangement for creation of security, maintenance, statutory charge creation etc., shall be included in the agreement with NBFC.
Monitoring, recovery and asset classification	• The co-lenders shall establish a framework for monitoring and recovery of the loan, as mutually agreed upon. • 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.

Inspection and Audit	The loan under the CLM shall be included in the scope of internal/ statutory audit within the Bank's and NBFCs to ensure adherence to their respective internal guidelines, terms of the agreement and extant regulatory requirements.
Other conditions	• 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 • Any assignment of a loan sourced through this arrangement by a co-lender (NBFC) to a third party can be done only with the consent of the other lender (bank). • Both the banks 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.

Conclusion

The primary focus of the revised scheme, rechristened as "Co-Lending Model" (CLM), is to improve the flow of credit to the unserved and underserved sector 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 the NBFCs. The policy is framed as per the guidelines published by RBI. Any amendments to the policy due to internal requirements or due to modification in RBI norms shall be submitted to Board for approval.

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