State Bank of India

Policy

for

‘Co-lending by BANK and NBFCs

to Priority Sector’

<u>Date: 14.06.2022</u>

<u>Version 2.0</u>

NBFC ALLIANCES DEPARTMENT

ABU & GSS

CORPORATE CENTRE

MUMBAI

1. Introduction:

1.1 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 risks and rewards.

1.2 RBI has 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. *However, outstanding loans in terms of the circular ibid would continue to be classified under Priority Sector till their repayment or maturity, whichever is earlier.* 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. The new scheme is christened as "Co-Lending Model" (CLM) under which, banks are permitted to co-lend with all registered NBFCs (including HFCs) based on a prior agreement. This policy for entering a Co-lending arrangement with the NBFCs has been formulated in line with the RBI guidelines.

2. Objectives:

2.1**.Creation of New Loan Book:** The reach of the NBFCs among the local population helps them to assess their financial needs and can help in increasing the Bank's loan portfolio in these areas. NBFCs can originate fresh loans in different loan categories in all segments, such as AGRI, SME, REH etc. for creation of priority sector assets as per a prior Master Agreement with the Bank.

2.2**. Support in Follow-up & Recovery:** NBFCs would also provide support in post sanction follow-up and recovery. It will increase the Bank's reach and business without increasing pressure on the rural branches, while keeping operating costs down.

2.3 **Lower NPA Rates:** Historical data shows that NBFCs usually have low levels of NPAs for activities where the Bank has traditionally struggled with relatively higher NPAs.

2.4 **Priority Sector Lending:** This proposed policy is meant to co-lend loans for the exclusive creation of priority sector assets. The co-lending of loans will enable the Bank to meet the PSL requirements in a convenient and more organised manner by sharing risks and rewards between the NBFCs and the Bank. Priority sector lending will be as defined by the extant RBI guidelines in force.

3. Essential Features of Co-Lending Model (CLM) between Bank & NBFCs:

3.1 Scope

3.1.1. In terms of the CLM, Bank is permitted to co-lend with all registered NBFCs (including HFCs) based on a prior agreement. As the co-lending bank, we will take our share of the individual loans on a back-to-back basis in our books. However, NBFCs shall be required to retain a minimum of 20 per cent share of the individual loans on their books. Further, Bank shall not be allowed to enter into a co-lending arrangement with an NBFC belonging to the promoter Group.

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

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

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 to comply with the extant guidelines on *Managing Risks and Code of Conduct in Outsourcing of Financial Services by Banks*. In particular, the Bank and partner NBFC shall 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. **Know Your Customer (KYC) Norms:** Bank shall be required to comply with the Master Directions – Know Your Customer (KYC) Direction, 2016, updated from time to time, which already permit 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 if it is as per RBI guidelines subject to the conditions mentioned under Chapter 5, Para 14 of RBI Master Direction on KYC updated as on 12/07/2018 which reads as under –

c. For verifying the identity of customers at the time of commencement of an account-based relationship, REs, shall at their option, rely on customer due diligence done by a third party, subject to the following conditions:

   i. Records or the information of the customer due diligence carried out by the third party is obtained within two days from the third party or from the Central KYC Records Registry.
   ii. Adequate steps are taken by REs to satisfy themselves that copies of identification data and other relevant documentation relating to the customer due diligence requirements shall be made available from the third party upon request without delay.
   iii. The third party is regulated, supervised, or monitored for, and has measures in place for, compliance with customer due diligence and record-keeping requirements in line with the requirements and obligations under the PML Act.
   iv. The third party shall not be based in a country or jurisdiction assessed as high risk.
   v. The ultimate responsibility for customer due diligence and undertaking enhanced due diligence measures, as applicable, will be with the RE.

   Therefore, Bank shall require partner NBFCs to agree to these conditions and share the KYC information with the Bank as stipulated above.

3.1.4 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.* Accordingly, bank shall ensure compliance with all the requirements in terms of RBI *Guidelines on Transactions Involving Transfer of Assets through Direct Assignment of Cash Flows and the Underlying Securities, vide* RBI Circular RBI/2011-12/540 DBOD No. BP. BC-103/21.04.177/2011-12 dated May 07,2012 with the exception of *Minimum Holding Period (MHP),* which shall not be applicable in such transactions undertaken in terms of this CLM.

3.1.5 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.

3.1.6 This shall imply that the loans will be first opened by NBFC and then Bank will open loan accounts afterwards. The NBFC can sanction and disburse the whole amount of the loan and then approach the bank for reimbursement (as clarified vide RBI mail dated 26.11.2020).

3.2. Customer related issues

3.2.1. 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 and responsibilities of the NBFCs and the bank.

3.2.2. All the details of the arrangement shall be disclosed to the customers upfront and their explicit consent shall be taken.

3.2.3. 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. Based on the respective interest rate and proportion of risk sharing, an all-inclusive rate is to be offered to the ultimate borrower in case of fixed rate of interest. In case of floating rate of interest scenario, weighted average of the benchmark interest rate in proportion to the sharing of risk is to be offered. Interest Rate charged by the Bank will be subject to applicable directions on interest rate on advances. Further, NBFC will also be required to abide by the pricing of credit and other applicable guidelines for loans for their contribution of loans. It is envisaged that the benefit of low cost of funds from banks and lower cost of operations of NBFC would be passed on to the ultimate beneficiary through the all-inclusive rate / weighted average rate. However, the break-up of all-inclusive interest rate viz. rate charged by the bank and rate charged by NBFC need not be necessarily communicated to the borrower.

Further, Interest Rate applicable under the model should be in line with Master Directions on interest rate on Advances 2016 undated on 10.06.2021.

3.2.4. Bank will re-imburse NBFC for the services viz., originating, administering and recovery of loans. The bank and NBFC shall have the flexibility to decide the methodology for such re-imbursement. Bank can either reimburse the NBFC for the services rendered or can factor it in the all-inclusive interest rate and the same can from part of the Master Agreement between the bank and NBFC.

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

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

3.2.7. 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.

3.3. Other Operational Aspects

3.3.1. The 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 bank, in order to avoid inter-mingling of funds. The Master Agreement shall clearly specify the manner of appropriation between the co-lenders.

3.3.2. 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.

3.3.3. The bank and NBFCs shall establish a framework for monitoring and recovery of the loans, as mutually agreed upon.

3.3.4. The bank and NBFCs shall arrange for creation of security and charge as per mutually agreeable terms.

3.3.5. The bank and NBFCs 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.

3.3.6. The bank and 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 two parties.

4. Selection of NBFCs:

4.1. Eligibility Criteria: For Co-Lending, NBFCs shall satisfy the following criteria.

Parameter	**Criteria**
External Credit Rating	**A (-) and above (*)**
Assets under Management	NBFC-Rs.100 Crore and above **HFC- Rs.1000 Crore and above**
Net worth	NBFC-Rs.10 Crore or more **HFC- Rs.100 Crore and above**

TOL/NOF :	NBFC- Up to 8 Times HFC - Up to 10 times
Gross NPA	Less than 5%
Capital Adequacy ratio (CAR)	NBFC/HFC-Min 15% (Min. Tier I Capital-10%)
Default track record of NBFC with lenders	Nil
Experience of NBFC in managing Asset Portfolio	2 years or more #
Liquidity Coverage Ratio	50%

(*) *For all Agri loans (irrespective of the limit) and loans under Micro Finance (up to Rs.1 lakh per individual), the minimum external credit rating acceptable is BBB.*

(#) *In respect of NBFCs offering multiple products, the experience requirement of 2 years shall apply for the specific product under consideration for co-lending.*

4.1.2 Financials to be used for determining eligibility:

- For listed Companies, latest Audited/ published financial statements to be considered for eligibility criteria.

- For unlisted Companies with no obligation for the quarterly review of financials, financial parameters as on year end date shall be considered. However, if any such parameter is outside the threshold value prescribed but there is an improvement in subsequent quarters, such improved financial parameter (s) may be considered, if the NBFC / HFC provides audited financial statements for the said quarter. It shall, however, be noted that all financial parameters used for evaluating the NBFC / HFC shall be from same quarter

Specific deviation as regards to selection of NBFCs, if any, may be approved by MD (RB &O).

4.2 Due diligence: Before putting up the proposal for on-boarding, due diligence of the NBFC will be conducted on the following parameters namely:

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

Further, the team processing the on-boarding proposal should check at least 20 sample loan accounts, mix of secured and unsecured loans, on random basis for acceptability of the origination/underwriting standards adopted by the NBFC to ensure good quality of assets and to avoid NPAs.

LGD/PD of the portfolio of the HFC may be looked at and commented upon as part of due diligence.

4.3 Selection Procedure: Circles/BUs may initiate discussions with the NBFCs in their respective areas for co-lending. On being satisfied about the Business Potential, the designated branch of the Circle will carry out the due-diligence as stated above and initiate the on boarding process through NBFC Alliances Department through respective BU at Circle. Due-diligence report along with all the supporting documents duly approved by CMC will be forwarded to NBFC Alliances Deptt, Corporate Centre for processing on-boarding process. BUs may also proactively scan the market to explore the possibility as there are several NBFCs operating in more than one segment.

The Committee to be constituted for selection of NBFCs should comprise of a CGM from one of the BUs (SMEBU/BD/REHBU), one GM from a BU other than the BU represented by CGM and GM (NBFC Alliances). DGM-NBFC Alliances will coordinate with the Selection Committee. Decisions on loan book size, vintage of NBFC and service charges, if any, will also be taken by the Committee. The draft Master Agreement (MA) with the concerned NBFC containing the details of the arrangement, duly vetted by Law Department, will also be approved by the selection committee. The Master Agreement with the NBFC on behalf of the bank will be signed by GM-NBFC Alliances.

The list of NBFCs/HFCs whose certificate of registration was cancelled by RBI, is to be verified before entering into an agreement with any NBFC/HFC for Co-lending. Periodical verification is to be carried out to identify such deregistered NBFCs and necessary action is to be initiated in case the bank has already entered into an agreement for co-lending.

4.4 Area of Operation and Credit Risk: Co-lending of loans with NBFCs may be restricted generally to their domain of expertise. It can be restricted either to one activity (Agri / SME / REH) or a combination. The same is to be incorporated in Master Agreement.

4.5 Type of Assets: Co-lending can be done for Retail oriented standard assets except for the following:

i. Revolving credit facilities (e.g. Credit Card receivables)
ii. Assets purchased from other entities
iii. Loans with bullet repayment of both principal and interest

4.6 Tenor of the loan:

Sr. No.	**Asset Type**	**Maximum Tenor of the Loan**
1.	Home Loan	Up to 30 years
2.	SME Mortgage-Backed Loan	Up to 15 years
3.	Other loans	Up to 8 years.

5. NPAs

a) **Recognition of NPAs**: Recognition of NPAs will be done as per RBI guidelines as applicable to the Bank and NBFCs respectively.

b) **Compromise and Settlement:** Bank's existing compromise & settlement policy will be applicable for Co-lending loans.

6. 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**.** Value Statements for these loans will, however, be different from those for accounts under Bank's regular schemes, as all aspects of loan life cycle management are not applicable.

7. Provisioning/Reporting Requirement: Bank and NBFC will follow independent provisioning requirements including declaration of accounts as NPA, as per the regulatory guidelines applicable to respective entities. Bank and the NBFC will carry out their respective reporting requirements including reporting to Credit Information Companies, under respective applicable laws and regulations for their portion of lending.

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

9. Grievance Redressal: It will be the responsibility of the NBFCs to disclose and explain to the end borrower regarding the details of the arrangement upfront and their explicit consent taken in the co-lending model. NBFC shall be primarily responsible for providing the required customer service and grievance redressal to the borrower. Suitable arrangements to 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.

Any procedural requirement/minor enablement for implementation of the policy may be approved by the vertical head ensuring that they follow the RBI's overall policy framework in this regard.

10. **Miscellaneous**

a) **Process and SOP:** DMD(ASF) will be authorized to approve modifications/review/revision in processes and SOP for Co-Lending.

b) Review/Renewal of the policy: The policy would be applicable to all the BUs. The proposed policy is in line with RBI's policy on Co-Lending of Loans by Bank and NBFCs and will be reviewed once in two years. The policy may however to be reviewed before the due date, if deemed necessary (due to extensive changes in regulations/instructions by RBI or GoI). Any changes in regulatory guidelines/other instructions from Govt./RBI may be advised to branches/offices with due approval from CGM (ABU & GSS). Such changes shall be deemed to be a part of policy the policy till the policy is reviewed.

c) Authority to approve any deviation under the is policy shall vest with MD (RB&O.)

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