# Co-Lending

*Lenders' collaboration to extend lending outreach and capabilities*

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Vinod Kothari Consultants

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# Abstract

*There are strong economic reasons for the existence of co-lending, as strengths of lenders get more and more differentiated, and need as well as the economic potential of co-lending, in providing more inclusive and affordable lending in the financial system increases.*

*Co-lending seems similar to loan syndications; however, the former is a horizontal network of lenders, whereby the co-lenders have typically been involved in the loan origination right from the inception. Syndicated lending existed for sharing exposures in large loans; co-lending is a term that became popular mainly in case of retail loan pools. Co-lending got its shot in the arm with the advent of digital lending.*

*The law of co-lending is a mix of limited purpose partnering in lending business (governed by intercreditor agreement), a lending arrangement between the co-lenders and the borrowers (governed by the facility agreement), and the joint promise that the borrower makes to the two co-lenders. Therefore, any legal proceeding against the borrower is to be initiated by the two co-lenders together.*

*Co-lending may exist both for priority-sector loans, as also non-priority sector loans. Regulatory recognition of the latter exists in the Digital Lending Guidelines.*

*Co-lending by its very nature is non-discretionary; a discretionary co-lending amounts to a transfer of loan exposures, and therefore, has to abide by the entire discipline of the TLE Directions. Limited exception in case of PSL loans was made, with the objective of reducing the cost of borrowing in case of such loans.*

*While RBI's co-lending framework was envisaged in case of PSL, the essential parameters of co-lending apply in case of non-PSL co-lending transactions too. Importantly, the minimum skin-in-the-game of a co-lender, 20% in case of PSL, needs to be ensured in non-PSL lending too.*

*Likewise, co-lending cannot be the arbitrage route to avoid the restrictions on first loss or structured default guarantees. It is not possible for a co-lender to guarantee a rate of return for the funding co-lender, as the same would amount to the funding co-lender virtually assuming exposure in the originating co-lender, rather than the borrower pool.*

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# Evolution of co-lending

## Collaborative lending

Collaborations between businesses for creating assets, having liabilities, carrying our operating activities, or doing ventures, whether for a limited period or purpose, or for longer period, indefinite period, etc., have existed for times immemorial. In the context of lending, there may be two or more (in the rest of this work, the expression two may, where befitting in context, include more than two as well) lenders joining together for a loan, or two borrowers joining together for a borrowing.

The motivations for lenders to join as co-lenders may be numerous - either because of the size of the loan, exposure restrictions, risk management, differential origination capabilities, differential level of franchise with the borrower base, etc.

The motivations for borrowers joining together for a borrowing may, likewise, be numerous - spreading or supporting of the liability, utilisation of the loan by the joint borrowers depending on need at different points of time, etc.

Collaborative lending takes place in many forms globally, some of which include syndicated lending, consortium lending, loan participations, participation certificates, etc. Collaborative lending seems to be the evolutionary phase, with similar forms of lender partnering - loan sales, loan assignments, or securitisation.

If the participation is not a loan level, but merely at origination level, there may be other forms of collaboration, such as loan sourcing agencies or direct selling agents, business correspondents, etc.

In the Indian context, "co-lending" has been an age-old concept in the context of consortium lending or syndicated lending; however, the application of the term to retail loans has recently gained increasing popularity amongst lenders. Given its economic rationale and simplicity, co-lending is expected to gain more traction going forward.

The coverage of this paper would be limited to an in-depth understanding of co-lending.

# Understanding co-lending

## What is Co-lending?

*Co-lending, as distinct from syndicated lending, is a horizontal network - that is, the two co-lenders are together while interfacing the borrower. In syndicated lending, on the other hand, the syndicate members usually take a share from the lead underwriter.*

Co-lending has been explained as a horizontal network of lenders. Two or more lenders come together to advance a loan. Normally, the due diligence will have been exercised by both the co-lenders. It is a horizontal network to the extent the co-lenders take part in the process of loan origination. If one lender originates a loan, and subsequently gets other participants to participate in it, as would be the case of loan participations, it becomes a vertical network. Usually, in syndicated lending, the entire borrower interface is carried by the leader of the syndicate; those who agree to take part in the syndicate or consortium take share in the loan rely on the lead role taken by the leader.

An article[1] discusses the legal nature of co-lending as an arrangement where "there is often an originating or agent lender, the co-lenders are usually direct parties to the credit agreement to the borrower. The relative rights and obligations of the co-lenders amongst themselves are governed by specific provisions in the credit agreement or in a separate co-lender agreement."

In the essence of co-lending, it is a contract between typically two parties to lend to a borrower. Both lenders decide and agree to lend to the ultimate borrower together, in accordance with the co-lending agreement executed between both lenders. The relationship between both the lenders is defined by a 'contract' between them (inter-creditor or co-lender agreement). While the relationship between the co-lenders and the borrower is defined by a 'loan agreement' between them.

[1] Christopher B. Price and Lauren T. Lebioda (2009), "Lender Defaults: The New Reality Facing Real Estate Debt Investors" - https://www.goodwinlaw.com/-/media/files/publications/attorney-articles/2009/price-lebioda-the-journal-of-stuctured-finance.pdf

The legal nature of the relationship between the co-lenders is defined by contract law. Co-lending picks up several elements of different types of contracts. To the extent two lenders agree to originate and partake in lending jointly, it is a limited purpose partnership or a pro tem joint venture. To the extent the two co-lenders extend a lending facility, the relation between the two of them together on one side, and the borrower on the other, amounts to a loan agreement. However, as there are two lenders together on the lender side, the borrower makes promises to two of them together, and therefore, the rights of any one of them is governed by the law relating to "joint promisees". Thus, co-lending law is a mix of a partnering law, lending law and joint contract law. In India, the Indian Contract Act, 1872 ['Contract Act'] deals with joint rights under section 45[2] of the Contract Act.

*Co-lending is a mix of several elements of contract law. It is based on the law of partnering, since the two co-lenders are coming together for business. It is lending law, as the facility is that of a loan. And the borrower makes promises to the two co-lenders - hence, it is governed by the law of joint contracts.*

## Judicial precedents w.r.t joint promisees

In the matter of *Govindlal Bhikulal Maheshwari vs Firm Thakurdas Bhallabhadas and ors. (1973)*[3], the Bombay High Court explained that section 45 of the Contract Act has two parts. The first specifies with whom the right to claim performance rests, in the case of joint promisees. The court held that "unless a contrary intention appears from the contract, the right to claim performance rests, as between the promisor and the joint promisees, *with the joint promisees during their joint lives."* The second part specifies with whom the right to claim performance rests in case of death of any of the joint promisees. Given the joint nature of the right, it has been the settled position of law that performance of the promise, in the instant case the loan, can be demanded and enforced by the two parties jointly, unless the two of them have nominated one of them, or a third party, to exercise the joint right as an agent.

[2] Section 45 of the Contract Act states: "When a person has made a promise to two or more persons jointly, then, unless a contrary intention appears from the contract, the right to claim performance rests, as between him and them, with them during their joint lives, and, after the death of any of them, with the representative of such deceased person jointly with the survivor or survivors, and, after the death of the last survivor, with the representatives of all jointly."

[3] https://indiankanoon.org/doc/333050/

It is also a settled common law principle that while liabilities can be joint and several, rights can be either joint, or several, but not joint and several. It is for this reason that civil law requires each of the joint promisees to be join in an action against the promissor.

## Indivisibility of mortgages and singleness of debt

Since creation of mortgage rights in favour of joint mortgagees has been a common phenomenon, there are several judicial precedents upholding indivisibility of mortgages, and singleness of debt.

In Adiveppa Channappa Kittur vs Rachappa Balappa Hosmane (1946)[4], Bombay High Court said "A mortgage is a contract, whereby the mortgagors usually, and as in this case, agree to repay a single total sum to the lender or lenders, and in default to have the single total sum raised by the sale of the security. It is not the contractual bargain that if the mortgagee's title should devolve on several co-owners, that each co-owner should have the right to demand piecemeal a proportionate sum and have such proportionate sums raised by the sale of the whole or some part of security. Such an arrangement could only arise from an express agreement with the mortgagors."

The rights of a co-mortgagee were also laid down by the Bombay High Court in the case *supra* by stating that in the case of co-mortgagees "a single co-mortgagee cannot sue to recover the entire mortgage amount on his own behalf; nor can he sue to recover his own share of the mortgage amount, as the mortgage is indivisible. *He must bring a suit to recover the entire amount on behalf of himself and the other co-mortgagees.*"

Referring to the ruling in *Huthasanan Nambudri v. Parameswaran Nambudri (1898)*[5], *Mohammed Ismail Maracair v. Doraisami Mudaliar*, reported in AIR 1958 Mad 621[6], Madras High Court made the following important remarks -

> *"It is well settled that a mortgage is one and indivisible in regard to the amount and security."*
>
> *" . . a mortgage for an entire sum is from its very purpose indivisible; a division of such a mortgage, borrowing the language of a text writer, is conceivable in theory and may be carried out in practice. But in order that a mortgage may fully attain its end of securing satisfaction of the entire obligation in the rank and with*

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[4] https://indiankanoon.org/doc/546781/?type=print

[5] I.L.R. 22 Mad. 209 at 211

[6] https://indiankanoon.org/doc/1222587/

*the efficacy which the law or the will of the parties determined, it is essential that it should not suffer any disintegration."*

*"This character of indivisibility exists not only with reference to the mortgagee, who may generally be more benefited thereby, but also with reference to the mortgagor. And save as a matter of special arrangement and bargain entered into between of all the persons interested, neither the mortgagor nor the mortgagee, nor persons acquiring through either a partial interest in the subject, can, under the mortgage, get relief except in consonance with the principle of indivisibility referred to."*

*"It is not open to some of the mortgagees to split up the debt without the concurrence of the other mortgagees and the mortgagor."*

In Peer Ammal v. Nalluswami Pillai (1937)[7], it was observed, "if it becomes necessary to sell the whole or anything in excess of a proportionate part of the hypotheca to realise even the amount due to the plaintiff-co-mortgagee, it will be neither fair nor consistent with the policy of the law to allow the plaintiff to appropriate the proceeds wholly in satisfaction of his claim. Justice can be done between all the parties concerned only by providing in the decree for the distribution of the sale proceeds amongst the co-mortgagees."

Thus, as remarked in *Sunitibala Debi v. Dhara Sundari Debi Chowdhurani (1919)*[8], it was a case of a single mortgage executed in respect of the same property to secure two sums of money respectively payable to two mortgagees. The Privy Council held that the mortgage clearly effected a conveyance of the real estate to the mortgagees as tenants is common and that *it was not a mortgage to each of a divided half but a conveyance to them of the whole property*.

In Maharashtra State Financial ... vs Ballarpur Industries Limited[9], Bombay High Court held that:

*". . .one co-mortgagee cannot sell or institute any proceeding for the sale of the mortgaged property without joining the other co-mortgagees. If the other co-mortgagees are not willing to join as plaintiffs, they should be joined as defendants. This is because the mortgaged security is one and it must be realised as a whole by a common sale."*

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[7] 2 M.L.J. 666 - https://indiankanoon.org/doc/575502/
[8] (1920) 22 BOMLR 1 - https://indiankanoon.org/doc/1482364/
[9] AIR 1993 Bom 392 - https://indiankanoon.org/doc/1732313/

Accordingly, co-lending would be a case of joint promisees, where the lenders jointly agree to lend to a borrower who is liable to both the lenders collectively under the loan agreement. The co-lenders have a joint right/claim over the debt owed by the borrower which stems right from the inception of the contract.

Co-lending is essentially akin to a joint ownership of the loan asset by and between the co-lenders; it is akin to a special purpose partnership, barring the principal-agent relationship essential to the concept of partnership.

The upshot of the discussion is as follows:

i. In case of co-lending, any action against the borrower can be taken in the name of both the co-lenders, as the borrower does not have individual facility agreements with the two co-lenders. It is an arrangement with the two co-lenders jointly.
ii. However, there is nothing wrong with the co-lenders appointing any of them, or a third party, as a servicer. In that case, the servicer exercises the rights on behalf of the two co-lenders.
iii. If any litigation is filed against the borrower, the same should be filed by the two co-lenders together. If one of the co-lenders refuses to join in an action, the aggrieved co-lender should also sue the non-cooperating co-lender for not joining in the action.

# The underlying economic rationale for co-lending

The coming together of two entities to partner and lend together can have several benefits. One of the parties may have strengths in areas that the other party does not. The underlying economic rationale/ the economic basis for lending together or co-lending is to exploit differential capabilities.

Entities may have strengths in one or more of these – retail deposits, wholesale funding sources, origination abilities in different customer segments, technology strengths, capital, etc.

It will be quite natural for these entities to do a win-win deal by aligning their differential abilities. For instance, if an entity is strong in, say, housing finance assets, and another one is strong in MSME loans, the two would find it much better by each focusing on their strong domains, and exchange their portfolios wrapped by the risk mitigation of the originating entities, if they decided to diversify their books in the asset domain where either of the entity does not have origination strengths.

There are also quite often different strengths on the liability side. There are several depository banks which have a strong franchise with retail investors, and there are periods when their deposit books swell. There are some P2P lenders as well who would have piled up very strong depositor interest. An alliance with origination-strong entities will lead to a win-win proposition for both of them.

During the Global Financial Crisis, financial regulators learnt a lesson that permitting entities to originate assets and transfer the same without skin-in-the-game may lead to adverse selection, abdication of underwriting standards, etc.

Hence, minimum risk retention requirements were laid down. Also, capital regulations have always stipulated capital to the extent of first loss risk. Therefore, as a matter of principle, if there is (a) capital provisioning, and (b) risk retention by the originator, there should not be regulatory concern.

## Risk and rewards in a co-lending model

The capital norms for financial entities have the intent to support risk taken with an appropriate level of capital to absorb the risks. To the extent that risk as well as capital needed to support the risk stay where the loans are, there should not be any issue. The idea is that if there are any losses, the contributors to capital should absorb those losses and the losses should not be passed on to the system resulting in systemic failure.

These are basic principles and in case of co-lending, the co-lenders should also have risk and capital in the same way. The risks and rewards of the partnership should be shared appropriately between the co-lenders. Furthermore, structures where an unregulated entity absorbs risk and lends without a license poses a greater risk in the system. This structure has also been highlighted in the "Report of the Working Group on digital lending including lending through online platforms and mobile apps"[10] and recommended that regulated entities should not allow their balance sheets to be used by unregulated entities in any form to assume credit risk.

# State of the market

There are reports[11] that the size of co-lending market in India crossed Rs. 10,000 crores as on September, 2022. These, however, are the numbers for co-lending done only

[10] https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1189

[11] https://www.go-yubi.com/wp-content/uploads/2022/12/Final-colending-report-2.pdf

through a fintech platform. More recent reports[12] suggest co-lending has crossed the Rs. 25,000 crores mark in FY23, highlighting a more than fourfold increase from FY22 numbers.

These however show numbers for only bank co-lending with NBFCs. In the authors' view, the volumes of co-lending may be much higher than those being reported.

The market has faced some disruption with the advent of the Digital Lending Guidelines, through which there was a ban on synthetic structures that were very prevalent in the market. Financial entities were looking for ways to modify the existing structures to bring them in line with the concerns highlighted through the RBIs digital lending guidelines.

Co-lending structures emanated from the priority-sector lending (PSL) market, but soon spread to non-PSL business too. The spurt in co-lending came with digital lending. Digital lending entities were able to use their platforms and models to identify, capture and convert a huge number of small borrowers. However, these entities lacked funding strength. On the other hand, banks and NBFCs had substanding funding abilities, without the capability to originate digital loans. The situation created the right conditions for co-lending. Thus, there was a proliferation of co-lending arrangements between banks and digital lenders, NBFCs and digital lenders, etc.

# Partnering in lending - structures in the market

In the context of partnering in lending, several structures are prevalent. Many of these structures are growing in terms of number of partnerships. Regulated entities (i.e., those entities that are regulated by RBI such as banks/ NBFCs) are entering into partnering structures with regulated as well as non-regulated entities to unlock their respective synergies.

Some of the modes of partnering in lending are discussed below.

## Co-lending structures:

Under the co-lending structure, two entities join hands and enter into a partnership to lend jointly to borrowers. The partnership may be between two or more banks, two or

[12] https://economictimes.indiatimes.com/industry/banking/finance/co-lending-rises-over-fourfold-in-fy23-assets-cross-rs-25000-crore/articleshow/99416339.cms

more NBFCs or a combination of banks and NBFCs. However, ordinarily we have seen co-lending structures with two regulated entities partnering together to lend.

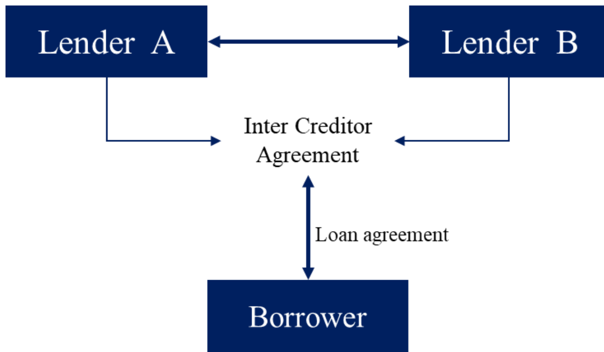


*Figure 1: Co-lending Structure*

The two lenders jointly agree to lend to the borrower in a pre-defined ratio. One of the lenders agrees to act as a servicer on behalf of both the parties. The rates of interest expected by the two co-lenders may be different; however, they agree on a blended rate of interest, that is, the weighted average of the differential rates of interest, and the share of the two in the principal. All of the terms and conditions may be covered in a common agreement formally executed between the two. Details of co-lending structures are discussed in depth throughout this paper.

## Banking Correspondents model:

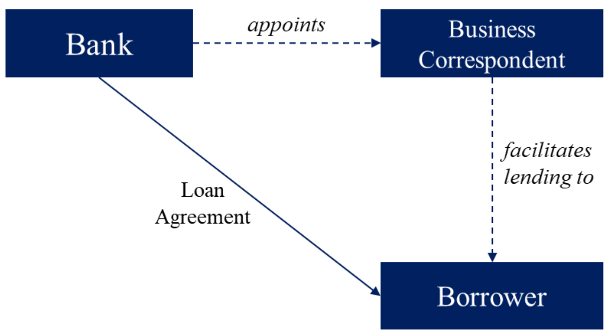


*Figure 2: Banking Correspondents model*

Business Correspondents (BCs) are those entities that are set up to facilitate financial inclusion in areas that are underserved or lack the appropriate banking facilities. BCs are appointed by banks. BCs act as an extension of banking services. The partnering model

here includes a bank engaging a BC which may be individuals, individual owners of kirana stores, NGOs, co-operative societies, post offices or companies.

Essentially, the function of a BC is to assist customers in availing banking services, where banks do not otherwise have presence in the said region. The activities may include facilitating account opening, collection/ recovery, follow ups, etc.

No funding is deployed by a BC; the customer is the customer exclusively of the bank. The role of the BC is simply facilitating the relation between the bank and the customer.

## Direct Sales Agents/ Direct Marketing Agents:

Direct Sales Agents/ Direct Marketing Agents (DSA/ DMA) is also a prevalent mode of partnering for the purpose of sourcing customers. Regulated entities such as banks and NBFCs outsource certain functions while engaging DSAs/ DMAs to facilitate their business. The role of DSAs/ DMAs may be to source customers, market products, facilitate the application process, etc., for a fee.

## Loan Sourcing Partnership:

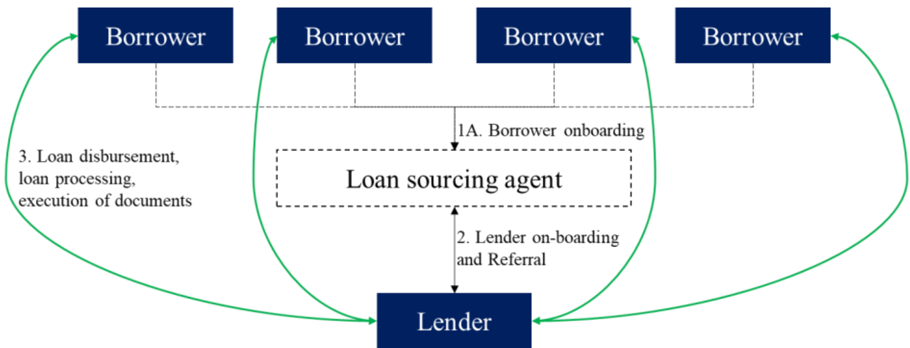


*Figure 3: Loan Sourcing Partnership*

The sourcing structure is a more specific case of DSA/DMA model, in that one of the parties acts as a sourcing agent in order to facilitate customer acquisition and other functions related thereto. Regulated entities may engage regulated/non-regulated entities as a sourcing agent by way of an agreement. This is one of the more popular models in recent times, especially in the digital lending space.

## Marketplace lending:

Marketplace lending is one where there is a technology-enabled marketplace of lenders and borrowers. Lenders and borrowers register themselves in a virtual marketplace.

Borrowers put their loan requests, with such financial data as is required by the platform. The platform normally does some extent of data screening and analysis on the prospective borrower. If the borrower has a history of successful borrowings on the platform, that is also used by the platform in providing some information on the quality of the borrower. Lenders may compete to take the whole or parts of the loan.

P2P platforms are a case of marketplace lending; however, marketplace lending does much beyond P2P lending. The idea of P2P lending is non-financial lenders, that is, peers, on the lending side of the transaction. On the other hand, marketplace lending has regulated entities as lenders, too.

The marketplace or the platform provider is, in real sense, not a lending partner. Marketplaces are neutral platforms that simply enable flow of information between prospective lenders and borrowers. A marketplace is neither a lender, nor a borrower. Hence, a pure marketplace provider neither takes a part of the loan, nor the risks of a loan. Usually, marketplace providers should also not be a part of the financial flow from the lenders to the borrowers or vice versa - the flow of funds should be enabled by payment aggregators or similar payment service providers.

By arranging a loan to be split across various lenders, a marketplace provider may also act as a platform for co-lenders to come together.

The practices by US marketplace lenders to create “loan participation notes” have come under judicial as well as regulatory scrutiny - whether such notes amount to “securities”, and whether the marketplace lender may bring a bank as the loan originator, though with the avowed objective of downselling the loan to market participants. These issues have been discussed in another report[13].

## Co-lending in Physical vs Digital Lending

The traditional mode of lending face-to-face with customers over the counter and at brick-and-mortar outlets has witnessed a positive disruption with the advent of digitisation of the lending process. The categories under which partnership in lending takes place can therefore be categorised into digital and non-digital lending structures. These are discussed in further detail below.

[13] https://vinodkothari.com/wp-content/uploads/2023/02/India-P2P-report-Q3FY2022-23.pdf

## Digital lending

The advent of digital lending has picked up along with co-lending in recent years. Fintech entities and digital lending have grown at a faster pace than regulations, bringing in the need for regulators to catch up to innovation. The combination of these two fast growing concepts, i.e., digital lending and partnership in lending, leads to very interesting and innovative structures in the fintech industry.

The Guidelines on Digital Lending[14] ("DL Guidelines") issued by RBI brought some regulation, and therefore, harmonisation in the digital lending market. Several structures that prevailed prior to the guidelines were forced to change or shut completely. However, the DL Guidelines have enabling provisions for co-lending structures that use digital lending as a mode to co-lend. RBI has taken cognizance of co-lending outside of the priority sector, which is discussed in detail under the regulatory framework section.

## Non-digital lending

Where lending is not digital, that is, where predominant use of digital techniques for a seamless and generally contactless journey at the time of origination of the loan does not exist, the lending is not digital lending, and hence, it is traditional lending. Needless to say, co-lending may exist, for one or more reasons discussed earlier, in case of traditional lending.

Irrespective of whether the lending is digital or traditional, the essential tenets of co-lending are still applicable.

# PSL and non-PSL co-lending

As discussed earlier, the genesis of co-lending lay in priority-sector lending, where the RBI permitted banks to enter into co-lending relations with NBFCs. The latter had last mile outreach, whereas the former would have strong funding base. Hence, the NBFC will be sourcing-cum-servicing partner, take a share of the loan, and the bank will take the larger share. As expected, the bank will charge a lower rate of interest, whereas the NBFC's expected rate will be higher, resulting into a blended rate for the borrower.

If the lending not a priority-sector lending, there is no reason for co-lending arrangements not to exist, and in fact, the DL Guidelines has a regulatory recognition of co-lending in the sphere of non-PSL lending. Once again, irrespective of the nature of the loan - PSL or non-PSL, the fundamental principles of co-lending should apply in either scenario.

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[14] https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12382&Mode=0

## Discretionary and non-discretionary co-lending:

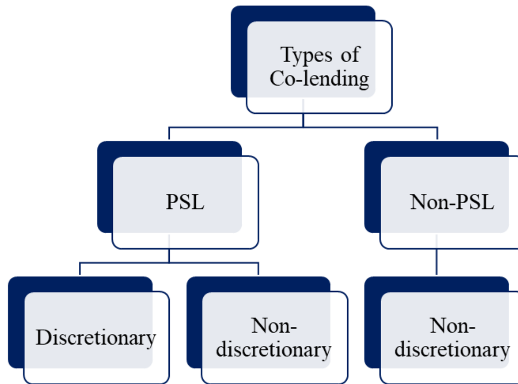


*Figure 4: Discretionary and non-discretionary co-lending*

As discussed above, co-lending is a "horizontal network", that is to say, the lenders are together from the inception. That is to say, one co-lender (let us say, the funding co-lender) has authorised the originating co-lender to source customers, under predefined sourcing or underwriting criteria. Once the loan fits into the criteria, the funding co-lender does not have the discretion of not taking the defined share of the loan. In that sense, co-lending is necessarily non-discretionary.

On the other hand, syndicated lending is mostly discretionary, as the lead underwriter brings syndicate partners onboard subsequently; the syndicate members generally do not take part in the loan origination process.

If by discretionary co-lending is meant the funding co-lender to cherry-pick loans, such cherry picking is essentially nothing but loan assignment, or transfer of loan exposures. That is to say, once a loan facility has already been originated, and the funding co-lender then selects the loans that he wants to buy, it is a case of transfer of a part of the loan exposure.

# Regulatory Framework

## Background

As discussed earlier, co-lending is essentially a limited purpose partnership between parties, and as such, is ordinarily governed by the provisions of the Contract Act, 1872. Co-lending transactions are thus ordinarily undertaken through contractual arrangements between the co-lenders.

The RBI had introduced guidelines for co-origination of loans by Banks and NBFCs for lending to the priority sector in September, 2018[15] ('Co-origination model' or 'CLM-1'). Subsequently, in November, 2020, RBI issued a revised set of guidelines for co-lending by banks and NBFCs to the priority sector[16]('Co-lending Model' or 'CLM-2' or 'CLM Guidelines'). These guidelines recognised the concept of 'co-lending' in India, though co-lending arrangements between financial entities have been in existence even before the regulations were issued.

While the guidelines are restricted to co-lending by financial institutions to the priority sector, co-lending is a wider concept and is used outside of the priority sector context as well. There is a strong feeling that co-lending is being widely used as the device of bridging the origination and funding of retail loans by two entities, and essentially a reflection of entities trying to make use of their differentiated origination and servicing capabilities.

## Co-lending for priority sector loans:

In India, banks have certain targets with respect to lending to the 'priority sector' imposed by RBI and hence, in order to help banks achieve these targets, the CLM Guidelines was introduced, which helps leverage the comparative advantages of banks and NBFCs while lending to the priority sector. Thus, the CLM Guidelines were introduced for co-lending of loans that qualify for the purpose of 'priority sector lending' ('PSL').

The CLM Guidelines require the banks and NBFCs entering into a co-lending arrangement to have a 'Master Agreement' for the purpose of implementing the CLM. The said agreement must provide for the bank to either take its share of the loans originated by the NBFC on its books or retain discretion to reject certain loans subject to due diligence.

This case of exercising discretion was not earlier permitted under the CLM-1 framework. Under CLM-1, both the lenders had to lend from inception.

In case discretion is exercised by the bank with respect to the loans it takes on its books (so-called 'cherry picking' of loans or 'discretionary co-lending'), the same will be akin to a direct assignment transaction. In this case, the bank taking over the loans on a discretionary basis would have to comply with all the requirements of the Master

[15] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11376&Mode=0
[16] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11991&Mode=0

Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021[17] ('TLE Directions') with the exception of the Minimum Holding Period ('MHP') requirements.

The intent of permitting discretionary co-lending in the PSL CLM framework is to promote PSL loans and ultimately reduce the interest rate for the borrower, through the blended rate of interest. Thus, discretionary co-lending is an exception under the CLM framework[18]. Discretionary co-lending has been discussed in greater detail below.

## Applicability

The erstwhile Regulations for priority sector lending covered co-lending transactions of Banks and Systemically Important NBFCs. However, under the Co-Lending Model. The CLM covers all NBFCs (including HFCs) in its purview.

There is a whole breed of new-age fintech companies using innovative algo-based originations, and aggressively using the internet for originations, and these companies pass a substantial part of their lending to either larger NBFCs or to banks. Thus, the expanded ambit of the Co-Lending Model will increase the penetration and result into wider outreach, meet the objective of financial inclusion, and potentially, reduce the cost for the ultimate beneficiary of the loans. Smaller NBFCs have their own operational efficiencies and distribution capabilities; hence, this is a welcome move. Further, the RBI has excluded foreign Banks, including wholly owned subsidiaries of foreign banks, having less than 20 branches, from the applicability of the CLM. Also, Small Finance Banks, Regional Rural Banks, Urban Cooperative Banks and Local Area Banks have been excluded from the applicability of CLM.

An interesting question that comes up here is whether such exclusion should be construed as a restriction on such entities from entering into co-lending transactions, or a relaxation from the applicability of the Co-Lending Model? It may be noted that the CLM is a precondition for PSL treatment of the loans. This is clear from the title 'Co-Lending by Banks and NBFCs to Priority Sector'.

The intent is not to put a bar on the existence of co-lending arrangements outside the CLM. That is to say, if the loan, originated by the principal co-lender, is a priority sector

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[17] https://rbidocs.rbi.org.in/rdocs/notification/PDFs/86MDLOANEXPOSURESC6B1DFB428C349D885619396317F04DE.PDF

[18] See our article on CLM Guidelines issued by RBI here: https://vinodkothari.com/2020/11/new-model-of-co-lending-in-financial-sector-scope-expanded-risk-participation-contractual-borders-with-direct-assignment-drawn/

loan, then the participating co-lender will also be able to treat the participant's share of the loan as a PSL, subject to adherence to the conditions specified in CLM. The implication of this is that where the loan does not meet the conditions of CLM, then the participating bank will not be able to accord a PSL status, even though the loan in question is a PSL loan.

With that rationale, in our view, there is no absolute prohibition in the excluded banking entities from being a co-lender. However, if the major motivation of the co-lending mechanism under the CLM is the PSL tag, that tag will not be available to the excluded banks, and hence, the very inspiration for falling under the arrangement may go away. This is also clear from the PSL Master Directions[19] which recognises co-origination of loans by SCBs and NBFCs for lending to the priority sector and specifically excludes RRBs, UCBs, SFBs and LABs.

## Co-lending, Outsourcing and Direct Assignment – new borderlines of distinction

For the purpose of entering into co-lending transactions, banks and NBFCs will have to enter into a 'Master Agreement'. Such agreement may require the bank either to mandatorily take the loans originated by the NBFC on its books or retain discretion as to taking the loans on its books. Where the participating bank has a discretion as to taking its share of the loans originated by the originating partner, the transaction partakes the character of a direct assignment.

Para 1(c) of the CLM says that "…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, the taking over 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…. with the exception of Minimum Holding Period (MHP) which shall not be applicable in such transactions undertaken in terms of this CLM."

It is also pertinent to note Para 40 of the TLE Directions, which states as follows:

The above MHP requirement is not applicable to loans transferred by the arranging bank to other lenders under a syndication arrangement.

We get the following implications from a conjoint reading of the above:

[19] https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11959

i. Syndication arrangements are akin to co-lending, except that the participating lending is not in picture at the time of origination. Hence, syndication is also in the nature of transfer of loan exposure.
ii. Discretionary co-lending is a case where a loan has been originated, and subsequently, a lender, at his discretion, enters the loan. This is also treated as a transfer of loan exposures.
iii. MHP requirements do not apply to syndication arrangements. Syndication is referred to in the regulations only in case of banks.
iv. MHP requirements do not apply to discretionary co-lending, as provided for in case of PSL lending.
v. All other provisions of TLE Directions apply to both syndications, as well as discretionary co-lending.

Co-lending, generally, is non-discretionary. The exercise of discretion lies in lender choosing his partner, and laying down the credit filters. Once a credit fits into the filter, the co-lender should be onboard, from the inception of the loan itself. That would mean, a precondition for the arrangement being treated as a CLM is that the participating bank takes the loans originated by the originating partner without discretion exercisable on a cherry-picking basis.

Does this mean that irrespective of whether the loan originated by the originating partner fits into the credit screen of the bank or not, the bank will still have to take it, lying low? Certainly, this is not the intent of the CLM. This is what comes from clause 1(a)- '…. 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.' Thus, even in case the bank gives a prior, irrevocable commitment to take its share of exposure, the same shall be subject to an ex-ante due diligence by the bank.

*Ex-ante* obviously implies prior due diligence, based on stipulation. Thus, the due diligence here is parametric rather than factual. As per the outsourcing guidelines for banks[20], the credit sanction process cannot be outsourced. Accordingly, it must be ensured that the credit sanction process has not been outsourced completely and the bank retains the right to carry out the due diligence as per its internal policy. Notwithstanding the bank's due diligence exercise, the co-lending NBFC shall also simultaneously carry out its own credit sanction process. The conclusion one gets from the above is as follows: The essence of co-lending arrangement is that the participating bank relies upon the lead role played by the originating lender. The originating lender is the one playing the fronting role, with customer interface. The credit screens, of course, are pre-agreed and it will naturally be incumbent upon the originating lender to abide by those. Hence, the

[20] https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=3148&Mode=0

participating bank is not doing a case-by-case selection or so-called "cherry picking" of the loans. If that is what is being done, the transaction amounts to a DA. Subject to the above, the participating bank is expected to have its credit appraisal process still on. Where it finds deviations from the same, the participating bank may stop the arrangement, or require the originating co-lender to take over such loans as have been originated in breach of representations and warranties.

It is important to note that if DA comes into play, the requirements such as MHP, MRR, true sale conditions, etc. will also have to be complied with. However, co-lending transactions do not have any MHP requirements, unlike in case of either DA or securitisation. Of course, co-lending transactions do have a risk retention stipulation, as the CLM require a 20% minimum share with the originating NBFC. Hence, the intent of the RBI is that co lending mechanism must not turn out to be a regulatory arbitrage to carry out what is virtually a DA, through the CLM.

### (Almost) A new model of direct assignments: assignments without holding period

Para 1 c. of the Annex seems to be leading to a completely new model of direct assignments – direct assignments without a holding period, or so-called on-tap direct assignments. Reading para 1 c. suggests that while co-lending takes the form of a loan sharing at the very inception, the reference in para 1 c. is to loans which have already been originated by the NBFC, and the participating bank now cherry-picks some or more of those loans. The cherry-picking is evident in "if the bank can exercise its discretion regarding taking into its books the loans originated by NBFC". However, unlike any other direct assignment, this assignment happens on what may be called a back-to-back arrangement, that is, without allowing for lapse of time to see the loan in hindsight. In essence, there emerge 3 possibilities: A non-discretionary loan sharing, which is the usual co-lending model, where the originating co-lender has a minimum 20% share. A discretionary, on-tap assignment, where the originating assignor needs to have a minimum 20% share A proper direct assignment, with minimum holding period, where the assignor needs to have a minimum 10% share. The on-tap assignment referred to above seems to be subject to all the norms applicable to a direct assignment, other than the minimum holding period.

## Co-lending for non-priority sector loans

The intent of the CLM was to enable priority sector treatment in case of banks partnering with NBFCs. The RBI has guidelines in place for regulating the co-lending arrangement between a bank and NBFC for PSL loans. However, the other co-lending arrangements, like those between NBFC and NBFC as well as those for non-PSL loans were not

regulated as such. Most of the co-lending transactions are accordingly undertaken based on the contractual and commercial arrangement between the co-lenders.

There does not seem to be a reason to contend that co-lending is not possible outside of the priority sector. Co-lending is a simple case of two lenders joining together for extending a loan, as has been done, over the years, in case of corporate loan exposures under consortium lending approach. Without doubt, each of the lenders do their own due diligence, both for credit and KYC purposes. They may have a mutual co-lenders' agreement, in addition to an agreement with the borrowers (which may, understandably, be a common agreement). They may agree on a blended interest rate, and put all loan repayments into a common account from where the two co-lenders may split the repayments to their separate bank accounts. One of them may act as the servicer, for the purpose of maintaining interface with the borrowers, and failing such an arrangement, both of them will have a privity with the customer.

## RBI takes cognizance of non-PSL co-lending

Further, there has been a footnote inserted in the Digital Lending Guidelines stating that Co-lending arrangements shall be governed by the extant instructions as laid down in the Circular on Co-lending by Banks and NBFCs to Priority Sector dated November 05, 2020, and other related instructions. The possible interpretation of the aforesaid footnote could be as follows:

- First, only those co-lender transactions that are between bank and NBFC for PSL loans would be exempted from the restriction on flow of funds to a third-party account.
- Second, all co-lending transactions are to be in line with the RBI Circular on Co-lending.

The first interpretation may not be feasible since, majority of co-lending in the market is happening for non-PSL loans and co-lending transactions would necessarily require the flow of funds from either of the co-lenders. Going by the second interpretation would mean that all co-lending transaction would have to pari materia follow the existing RBI regulations, including but not limited to a minimum loan share of 20%. There were several co-lending transactions prevalent in the market wherein the loan sharing ratio was 99:1 or 95:5 or 90:10.

This would mean that all such co-lending would have to fall in line with the 80:20 loan sharing requirement. It is also peculiar to have this kind of a direction flow from a mere 'footnote' which usually is to clarify the terminology or concept.

It can be said that through this footnote, the RBI has taken cognizance of co-lending for non-priority sector cases as well.

## Non-PSL loans: whether the framework would apply *in pari materia*?

The guidelines on CLM have been issued for co-lending of loans that qualify for the purpose of priority sector lending. This does not bar lenders from entering into co-lending transactions outside the purview of these guidelines. The only difference it would make is such loans would not be eligible to be classified as loans to the priority sector (which is the primary motive for banks to enter into co-lending transactions). This seems to form a view that the guidelines would not at all be applicable in case of non-priority sector loans. However, for a transaction to be a co-lending transaction, there has to be adequate risk sharing between the co-lenders. Hence, the guidelines on CLM shall be applicable in pari-materia.

## Generalisation of co-lending in India

One may generalize co-lending in India as follows:

| Particulars | Discussion |
|---|---|
| Number of co-lenders | Two, but there may be more than two as well. However, the practice should not be one of selling participations to several investors, as that may amount to formation of a collective investment vehicle. |
| Nature of co-lenders | Financial sector entities, engaged in the business of giving loans |
| Type of loans | Priority sector or non-priority sector loans |
| Minimum share of each co-lender | In the case of the CLM framework, there is a minimum 20% retention by the originating co-lender. While there is no regulatory stipulation in this regard, but in order to ensure skin-in-the-game of the originating co-lender, the latter should continue to have a minimum participation, say, 20%. If the originating co-lender retains an insignificant share, it will be cutting against the principle of risk-retention, and may be taken at par with a transfer of loan exposures. |
| Sharing of risks and rewards | In view of the differential role of the different co-lenders in the arrangement, the rates of return in the loan(s) may be shared differently by the co-lenders. However, see comments below on one co-lender giving assurance to other co-lenders |

| Particulars | Discussion |
|---|---|
| Is the originating or servicing co-lender providing any services to the arrangement | This question may arise primarily from GST or taxation viewpoint - can it be argued that the co-lender who is retaining higher interest is actually providing services to the arrangement, and therefore, should be paying GST on the services to the consortium? In this case, the arrangement is not in the nature of a joint venture, with the venture being a separate entity. It is simply a case of differential services performed by each of the co-lenders, and hence, the question of any services provided by one to the arrangement does not arise. |
| Interest Rate | an all-inclusive rate is communicated to the borrower that is mutually agreed by the co-lenders |

## Discretionary and non-discretionary co-lending

The so-called discretionary co-lending amounts to cherry picking of the loans by the financing co-lender after the loans have already been originated. If the loan has been originated, the case is one of assignment of an existing loan relationship. Therefore, except where the arrangement falls under the CLM framework for PSLs, it should be clear that assignment of an existing loan to a participating co-lender amounts to a transfer of a loan exposure, and not co-lending.

The intent of allowing cherry-picking of loans by the financing lender is to allow it a reasonable amount of time to carry out due diligence of the loans, before taking them on their balance sheet, and eventually to provide the benefit of lower interest rates to the PSL borrowers - as the financing lender would be able to choose assets with preferred risk features and it is likely that the borrower would be charged overall a lower rate of interest due to the blended rate of interest.

In fact, the CLM for PSLs also says (discussed earlier as well) that if a bank can exercise its discretion regarding taking into its books the loans originated by the NBFC as per the Agreement, the arrangement is akin to a transfer of a loan exposure. Accordingly, all the requirements of the Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021 shall apply, with the exception that the Minimum Holding Period ('MHP') requirements shall not apply for transactions undertaken in terms of the CLM regulations. Therefore, the exception for MHP is given as a carve-out.

As regards the discretionary co-lending for PSL loans, the following points may be noted:

While the discretionary co-lending framework permits the co-lender to come after the loan has been originated, the question is - how much time may elapse between the origination of the loan and the acquisition of the share by the financing co-lender? Can the financing co-lender, for example, come after 3 months of origination, and still call it a case of co-lent loan? As we have discussed earlier, the intent of permitting co-lending on a cherry-picking basis was specifically to provide the benefit of lower interest rates to the borrower in case of PSL loans. If the loan has already been running, it is unlikely that the borrower will get the benefit of reduced interest rates due to participation of the co-lender. Hence, in our view:

(a) The participation of the co-lender, though on a cherry-picked basis, should be soon after origination for the loan, say, before the first of the instalments falls due.

(b) The intent of the so-called discretionary co-lending is not to develop a track record of performance of the borrower, and then bring the financing co-lender as a co-lender. If MHP or nearabout has already been achieved, then there is no need to fall back on the CLM, as the TLE Directions may easily cover such a situation.

(c) The idea is to not leave CLM to give a profit to the originating co-lender, but to result into a benefit to the customer. Therefore, the entry of the co-lender, even though after origination of the loan, should result into a benefit to the borrower, maybe in form of a rebate or lower interest rate.

## Credit enhancement by the originating co-lender

The relationship between the co-lenders in a co-lending arrangement is similar to that of a 'special purpose partnership' with the exception of the principal-agent relations. Accordingly, in line with the principles of partnership, the co-lenders are partners in profits, and in losses. As in case of partnerships, the capital contribution ratio, profit sharing ratio and loss sharing ratios may all be different. Besides, different partners may have different roles in the arrangement. However, is it possible for the originating co-lender to secure the returns of the financing co-lender?

In any arrangement, the substance of the arrangement is what determines its regulatory treatment, and not its nomenclature. The substance of co-lending is that both the co-lenders are exposed to the underlying pool. They take risks and rewards in the pool, and not in one of the partners.

On the other hand, the idea of one co-lender guaranteeing or securing the returns of the other co-lender seems counterintuitive to the principles of partnership. If, for instance, the originating co-lender (a) retains a small portion of the risk sharing arrangement; (b) provides a guarantee to the funding co-lender protecting the funder from losses; and (c) also sweeps the actual rate of return from the collateral pool over and above the fixed

rate of return that goes to the funder, the arrangement partakes the character of a loan from the funder to the originator.

A so-called non-discretionary co-lending, where the funding co-lender relies on the credit due diligence done by the originating co-lender, would substantively look like a funding facility to the originating co-lender, if the funding partner is entitled to a fixed rate of return from the collateral pool. On the other hand, a discretionary co-lending, where the funding co-lender enters the loan after the same has been originated, takes the character of an assignment of a loan, and is, therefore, covered by the TLE Directions, which prohibits any form of credit enhancement by the originator.

Thus, in our view, provision of credit enhancement by the originating co-lender seems to be cutting against the principles of co-lending. Differential sharing of risks and rewards is possible, but a structure insulating the funder from risks, and depriving of rewards over a pre-fixed rate, seems unsustainable with the nature of co-lending.

## Interest Rates

The erstwhile guidelines require that the interest rate charged on the loans originated under the co-lending guidelines would be calculated as per Blended Interest Rate Calculations, that is to say the rate shall be calculated by assigning weights in proportion to risk exposure undertaken by each party, to the benchmark interest rate of the respective lender. The current guidelines require that the interest rate shall be an all-inclusive rate that is mutually agreed by the parties. However, it shall be ensured that the interest rate charged is not excessive as the same would breach the provisions of fair practice code, which is to be compulsorily complied.

This change would provide flexibility to the lenders and also ensure that the cost incurred in tracing and disbursals to remote sectors as well as enhanced risk exposure is appropriately compensated.

## Determining the roles

Under the erstwhile provisions, it was mandatory that the share of the co-lending NBFC shall be at least 20%. The same has been retained in the CLM as well, requiring NBFCs to retain a minimum of 20% share of the individual loans on their books. Under the CLM, the co-lending NBFC shall be the single point of interface for the customers. Further, the grievance redressal function would also have to be carried out by the NBFC.

## Operational Aspects

### Escrow Account

For the purpose of disbursals, collections etc. an escrow account should be opened. The co-lending banks and NBFCs shall maintain each individual borrower's account for their respective exposures. It is only for the purpose of avoiding commingling of funds, that an escrow mechanism is required to be placed. The bank and NBFC shall, while entering into the Master Agreement, lay down the rights and duties relating to the escrow account, manner of appropriation etc.

### Creation of Security

The manner of creation of charge on the security provided for the loan shall be decided in the Master Agreement itself.

Co-lending is being used in situations such as home loans, where there is creation of mortgage. The co-lenders may choose to have security created in their joint names; in which case it results into a joint mortgage. Alternatively, the co-lenders may have the mortgage created in the name of a trustee, who agrees to hold the mortgage in trust for the two co-lenders. Subject to proper disclosures to the borrower, it is also possible to think of one of the two co-lenders holding the mortgage in trust for the other co-lender.

### Filing with credit information companies

Ideally, filing with credit information companies should be done by either co-lender, based on the share taken by each. However, this results into the borrower seen as having taken two loans from two different lenders, whereas the borrower, in fact, has taken one single loan from two co-lenders. If the servicing agreement between the two co-lenders provides for filing of credit bureau reports by one of them, on behalf of the two, in our view, this should meet the requirements of the system. In fact, the credit bureau report is not a statement of customer outstandings from the lender - instead, what it intends to reflect is the credit availed by the customer. So, it is not the objective to match the credit bureau report filed by the servicing co-lender with the balances shown in the books of the co-lender.

### Accounting

Each of the lenders shall record their respective exposures in their books. The asset classification and provisioning shall also be done for the respective part of the exposure. For this purpose, the monitoring of the accounts may either be done by both the co-lenders or may be outsourced to any one of them, as agreed in the Master Agreement. Usually, the function of monitoring remains with the NBFC (since, it has done the origination and deals with the customer.)

## Transfer of loan exposures by a co-lender

A question arises, can a co-lender transfer his share in the shared loan to a third party? If a co-lending is taken as akin to a partnering or joint venture, it is the terms of the partnership or joint venture which govern any potential transfer of the co-venturer's share. As the relationship is based on mutual trust, it cannot be contended that a co-lender may freely sell or transfer his share without the concurrence of the other co-lender.

Therefore, the intercreditor agreement must govern the transfer of loan exposures to third parties. This will particularly be critical if it is the sourcing-cum-servicing lender who desires to transfer his exposure, as the funding co-lender would have relied on the strengths of the former.

## Restrictions on Default Guarantee Arrangements

Para 15 of the Digital Lending Guidelines (DL Guidelines) reads as follows:

> *15. Loss sharing arrangement in case of default: As regards the industry practice of offering financial products involving contractual agreements such as First Loss Default Guarantee (FLDG) in which a third party guarantees to compensate up to a certain percentage of default in a loan portfolio of the RE, it is advised that REs shall adhere to the provisions of the Master Direction – Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021 dated September 24, 2021, especially, synthetic securitisation8 contained in Para (6)(c).*

Further, the footnote 8 states- *"synthetic securitisation" means a structure where credit risk of an underlying pool of exposures is transferred, in whole or in part, through the use of credit derivatives or credit guarantees that serve to hedge the credit risk of the portfolio which remains on the balance sheet of the lender. Synthetic securitisation is a structure whereby*[21] *instead of transferring a pool of loans, the risk of the pool is transferred. Mostly, the device used is credit default swaps, but the more traditional instrument of guarantee is also referred to in the definition of synthetic securitisation by the RBI.* If the literal meaning of this para is taken, it would transpire that any form of risk transfer in a pool of loans by any lender, to a third party, is not permitted. To expand:

i. While the word used is FLDG, however, if the entire pool is protected, it does not deviate from the said provision being applicable.

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[21] Refer to Vinod Kothari's book on Credit Derivatives and Structured Credit Trading – https://vinodkothari.com/crebook/ Refer to our article on the revival of synthetic securitisation here- https://vinodkothari.com/2022/03/resurgence-of-synthetic-securitisations/

ii. If the guarantee is for the second loss piece, such that the first loss risk stays with the lender, and the third party (risk transferee) acquires a stake in the mezzanine tranche, is this also frowned upon? There is no doubt that mezzanine risk transfers are most common in synthetic securitisations – however, if the intent of the RBI was that the one who holds the loans dos not hold the risk, that problem does not exist in case of mezzanine risk transfers.
iii. What if the transferee of risk is a regulated entity? The mere fact that the guarantee is being provided by a regulated entity also does not change the applicability. The DL Guidelines would still be applicable for digital loans. In any case, unregulated entities cannot be the guarantee provider under the SSA Directions.
iv. What is the transferee of the risk is a co-lender? In a co-lending transaction, the originating co-lender provides a default guarantee, thereby protecting the losses of the funding co-lender. This is very common in most of the co-lending arrangements. It should also be noted that the restriction is on 'third party guarantees', however, the co-lender is a lender himself. To the extent the default guarantee is not vitiating the essence of co-lending as a partnership between two lenders, the same shall not be covered under the text of the Guidelines. It is a different issue that if the co-lender, with a 20% share, is bearing the risk of the 100% of the pool, and getting returns from the same, this is effectively no different from synthetic lending of the remaining 80%. However, one may choose to go by letters of the Digital Lending Guidelines, rather than the spirit.

Strangely, the synthetic securitisation bar has been extended in case of digitally originated loans. There is no reason why the same restriction should not be applied to any loans. If we take the bar to that extent, any form of credit risk transfers in case of any loan pools will be barred. This, however, will completely kill the market for risk mitigation and risk sharing.

# Comparison between co-lending and TLE

| Particulars | Transfer of loan exposures | Co-lending |
|---|---|---|
| **Use as a mode of transfer/acquisition of loan exposures** | Acquisition of a single loan or pool of loans, on bilateral basis | No transfer or pooling. Loans are originated by co-lenders pursuant to an arrangement between them- either discretionary or non-discretionary |

| Particulars | Transfer of loan exposures | Co-lending |
|---|---|---|
| **Intent of the buyer** | Should be typically expansion of loan book | NA – There is no buyer (there are co-lenders intending to build their books) |
| **Intent of the seller** | Liquidation of loan/loan book, reduction of concentration, etc | NA – There is no seller (there are co-lenders) |
| **Ease of execution** | High - loans are shifted from lender's book to acquirer's books. | High - Loans are co-originated by co-lenders and the customer facing is being done by any one of the lenders |
| **Legal method of "transfer"** | Assignment, novation or participation | NA – does not involve transfer |
| **Bankruptcy remoteness** | Yes | NA – co-lenders recognise the loan to the extent of their respective exposure |
| **Continuation of originator as servicer** | Possible | Normally, one of the co-lenders acts as servicer |
| **Credit enhancement by originator** | Not possible | Refer our discussion under the head, "Credit enhancement by the originating co-lender" |
| **Lender on record** | Assignor | Each co-lender for its loan share. For PSL loans, NBFC has to be the 'single point of interface'. For non-PSL, it would depend upon mutual agreement between co-lenders. Irrespective of who the point of contact is, both lenders would remain on record. |
| **MHP requirements** | Applicable | NA |
| **MRR requirements** | Not applicable where buyer does full DD, else 10%. | In case of PSL loans - if the originating co-lender is an NBFC, minimum risk retention of 20%. |

| Particulars | Transfer of loan exposures | Co-lending |
|---|---|---|
| **Capital relief** | Transferred loan/loan share reduces from assets; proportional capital relief. | None – loan is still on the books. However, the capital will have to be maintained only on the lender's exposure, and need not been on the entire loan. |
| **Cherry picking of loans** | Possible | Possible in case of discretionary co-lending permitted under the CLM regulations as an exception to promote PSL loans. Not possible in other cases. |

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