



# Bank-NBFC Co-lending

## Why in News

Recently, several banks have entered into **co-lending 'master agreements'** with registered [Non-Banking Financial Companies \(NBFCs\)](#), and more are in the pipeline. In 2020, the [Reserve Bank of India \(RBI\)](#) allowed the co-lending model based on a **prior agreement**.

- However, there are **some criticisms** associated with the co-lending.

## Key Points

### ▪ About the Co-Lending Model:

- **Background:** In September 2018, the RBI had announced ["co-origination of loans" by banks and NBFCs](#) for lending to the [priority sector](#).
  - The arrangement entailed joint contribution of credit and sharing of risks and rewards. **Co-lending or co-origination** is a set-up where banks and non-banks enter into an arrangement for the joint contribution of credit for priority sector lending.
  - These guidelines were **later amended in 2020 and rechristened as co-lending models (CLM)** by including Housing Finance Companies and some changes in the framework.
  - Under priority sector norms, banks are mandated to lend a particular portion of their funds to specified sectors, like weaker sections of the society, agriculture, MSME and social infrastructure.
- **Objective:** The primary focus of the 'Co-Lending Model' (CLM) is to "improve the flow of credit to the unserved and underserved sector of the economy."
  - It also envisages making available funds to the ultimate beneficiary at an affordable cost.
- **Underlying Idea:** CLM seeks to better leverage the respective comparative advantages of the banks and NBFCs in a collaborative effort.
  - The lower cost of funds from banks
  - Greater reach of the NBFCs.
  - For example, CLM will enhance last-mile finance and drive financial inclusion to MSMEs.
- **Example of CLM:** SBI, the country's largest lender, signed a deal with Adani Capital, a small NBFC of a big corporate house, for co-lending to farmers to help them buy tractors and farm implements.

### ▪ Risk in Co-lending:

- **Majority of Responsibility Lies with the Banks:** Under the CLM, NBFCs are required to retain at least a 20% share of individual loans on their books.
  - This means 80% of the risk will be with the banks — who will take the big hit in case

- of a default.
- In effect, while the banks fund the major chunk of the loan, the NBFC decides the borrower.
- **Corporates in Banking:** While the RBI hasn't officially allowed the entry of big corporate houses into the banking space, the NBFCs are mostly floated by corporate houses.
  - This is risky, especially when four big private finance firms — IL&FS, DHFL, SREI and Reliance Capita have collapsed in the last three years despite tight monitoring by the RBI.
- **Limited Reach of NBFCs:** While the RBI has referred to “the greater reach of the NBFCs”, the small NBFCs with 100-branch networks will fall short in serving underserved and unserved segments.

## Way Forward

- There is a need to give greater powers to the bank's board in order to drive, review & oversight the decision-making process. And for that, the best talent must be recruited.
  - Also, there is the requirement of a much stronger risk handling mechanism.
- The need is to now look at foreign markets, and set up appropriate business policies (in terms of the global location & the product these banks can target) that will help in increasing the efficiency and the competition of these banks with their global counterparts.
- Continuous reforms should be undertaken regarding,
  - Product innovation,
  - Investments in technologies,
  - Better back-end processes,
  - Reduction in turnaround time.

**[Source: IE](#)**

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