# 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**

PDF Refernece URL: https://www.drishtiias.com/printpdf/bank-nbfc-co-lending

दृष्टि The Vision