About | Awards | Blog | News Alert | kumar@ica.coo

ome > India > Technology

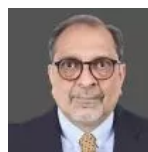
CONTRIBUTOR

Deze pagina bekijken in het: Nederlands Vertalen Uitzetten voor: Engels Opties ▼

intech Lenders

9 September 2023

y Bhargesh Ojha and Priyanka Biswas
handhiok & Mahajan



he Reserve Bank of India ("**RBI**"), vide its circular *RBI/2023-24/41 DOR.CRE.REC.21/21.07.001/2023-24, dated 8th ıne 2023* (**"Guideline")** has allowed banks and non-bank financiers to enter into loss default guarantee rrangements in digital lending if certain conditions are satisfied. These guidelines are applicable to First Default oss Guarantee ("FDLG") arrangements entered in 'Digital Lending' operations undertaken by entities regulated y the RBI and permitted to carry out lending business (hereinafter referred to as 'Regulated Entities' or 'RE'). A DLG is a contractual arrangement between a RE and a fintech or lending service provider (mostly unregulated) here the latter guarantees to compensate up to a certain percentage of default in the loan portfolio. The bank happy to extend the loan as the fintech sources the client (borrower) and also guarantee a part of the loss to ıe bank, in the event there is a default on the loan.

nder the Guidelines the following are considered to be RE - All Commercial Banks (including Small Finance anks); Primary (Urban) Co-operative Banks, State Co-operative Banks, Central Co-operative Banks; and Non-anking Financial Companies (including Housing Finance Companies).

he RBI was of the view that any other implicit guarantee of similar nature linked to the performance of the loan ortfolio of the RE and specified upfront shall also be covered under the definition of DLG.

Guidelines on Default Loss Guarantee (DLG) in Digital Lending

ligibility as DLG Provider – RE may enter into DLG arrangements only with a lending service provider ("LSP") or ther RE with which it has entered into an outsourcing arrangement. A LSP is an agent of a Regulated Entity who arries out one or more of lender's functions or part thereof in customer acquisition, underwriting support, ricing support, servicing, monitoring, recovery of specific loan or loan portfolio on behalf of REs in conformity ith extant outsourcing guidelines issued by the Reserve Bank. Further, the LSP providing DLG must be duly ıcorporated as a company under the Companies Act, 2013.

tructure of DLG Arrangements:

LG arrangements must be backed by an explicit legally enforceable contract between the RE and the DLG rovider. The contract must contain the extent of default loss guarantee cover, the form in which default loss uarantee cover is to be maintained with the RE, and timeline of default loss guarantee cover.

ap on DLG: RE shall ensure that total amount of DLG cover on any outstanding portfolio which is specified pfront shall not exceed five per cent of the amount of that loan portfolio. In case of implicit guarantee rrangements, the DLG Provider shall not bear performance risk of more than the equivalent amount of five per ent of the underlying loan portfolio.

ecognition of Non-Performing Assets ("NPA"): Recognition of individual loan assets in the portfolio as NPA and onsequent provisioning shall be the responsibility of the RE as per the extant asset classification and rovisioning norms irrespective of any DLG cover available at the portfolio level. The amount of DLG invoked hall not be set off against the underlying individual loans. Recovery by the RE, if any, from the loans on which LG has been invoked and realised, can be shared with the DLG provider in terms of the contractual rrangement.

ıvocation of DLG: The RE shall invoke DLG within a maximum overdue period of 120 days, unless made good by ie borrower before that. The RE shall put in place a mechanism to ensure that LSPs with whom they have a DLG rrangement shall publish the total number of portfolios and the respective amount of each portfolio on which LG has been offered.

ue Diligence and other requirements: There are certain due diligence requirements the REs need to comply ith prior to entering into DLG arrangement. The RE is required to put in place a Board approved policy which hall include, at the minimum, the eligibility criteria for DLG provider, nature and extent of DLG cover, process of ıonitoring and reviewing the DLG arrangement, and the details of the fees, if any, payable to the DLG provider.

has been made very clear by the RBI in its Guidelines that any DLG arrangement will not be considered a ubstitute for credit appraisal requirements and robust credit underwriting standards need to be put in place respective of DLG cover. Every time an RE enters into or renews a DLG arrangement, it shall obtain adequate ıformation, which shall include, at a minimum, a declaration from the DLG provider, certified by the statutory uditor, on the aggregate DLG amount outstanding, the number of REs and the respective number of portfolios gainst which DLG has been provided and any past default rates on similar portfolios. The purpose of gathering uch information is for the RE to satisfy itself that the entity extending DLG would be able to honour it.

he lender must ensure that LSPs publish the total number of portfolios and the respective amount of each ortfolio on which the guarantee arrangement has been offered on their website. Secondly, the fintechs must rovide the hard guarantee in the form of cash deposits, fixed deposits with lieu, or a bank guarantee in favour f the lender.

. Initial Reservations of RBI

BI had expressed reservations on the FLDG arrangement because it felt that the model could pose a systemic sk. It was observed that the fintechs were undertaking balance-sheet lending in partnership with a bank/ NBFC r on a standalone basis, while not satisfying the principal business criteria to remain outside regulation. reviously, entities were offering almost 100% FLDG to banking partners which exposed the banks and NBFCs to igh risk as they would disburse the loans taking comfort from FDLG, but when defaults occur, the fintech latform may not have money to compensate for the losses. This was happening outside the RBI regulations and BI opined that there were higher operational risks arising due to the increasing reliance of lenders on third-arty service providers.

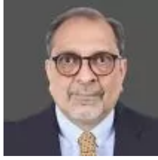
I. How has the fintech industry reacted?

he new framework was welcomed by the majority of stakeholders and experts who termed it as an enabling ıove by the RBI, providing much-needed clarity towards the relationship between REs and LSPs. The fintech ıdustry is further of the view that the Guidelines shall serve as a catalyst for encouraging partners of regulated ntities to participate in a more expansive and inclusive provision of micro-sized loans. The new norms will force Es to evaluate which LSPs they work with while others said the revival of the FLDG framework was essential for ntechs which are not making much headway in their alternative models or struggling to secure NBFC license for irect lending.

nother fintech player added that the cap of 5% will ensure the emergence of strong underwriting platforms eading to lower lending rates and believes that the Guidelines will encourage healthy competition and drive urther improvements in the lending sector. RBI's directives to invoke DLG within a maximum overdue period of 20 days unless resolved by the borrower, demonstrates a commitment to timely resolution of defaults which ill not only protect lenders from prolonged defaults but also encourage borrowers to take prompt corrective ctions, ultimately fostering a healthier lending environment.

he content of this article is intended to provide a general guide to the subject matter. Specialist advice should e sought about your specific circumstances.

AUTHOR(S)



Bhargesh Ojha
Chandhiok &
Mahajan

Priyanka Biswas
Chandhiok &
Mahajan

About | Blog | Contact Us | Contributors | Feedback | Free News Alerts | T&Cs | Unsubscribe | Your Privacy

© Mondaq® Ltd 1994 - 2023. All Rights Reserved.