

Students' ECONOMIC FORUM

A monthly publication from South Indian Bank

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To empower the student community...



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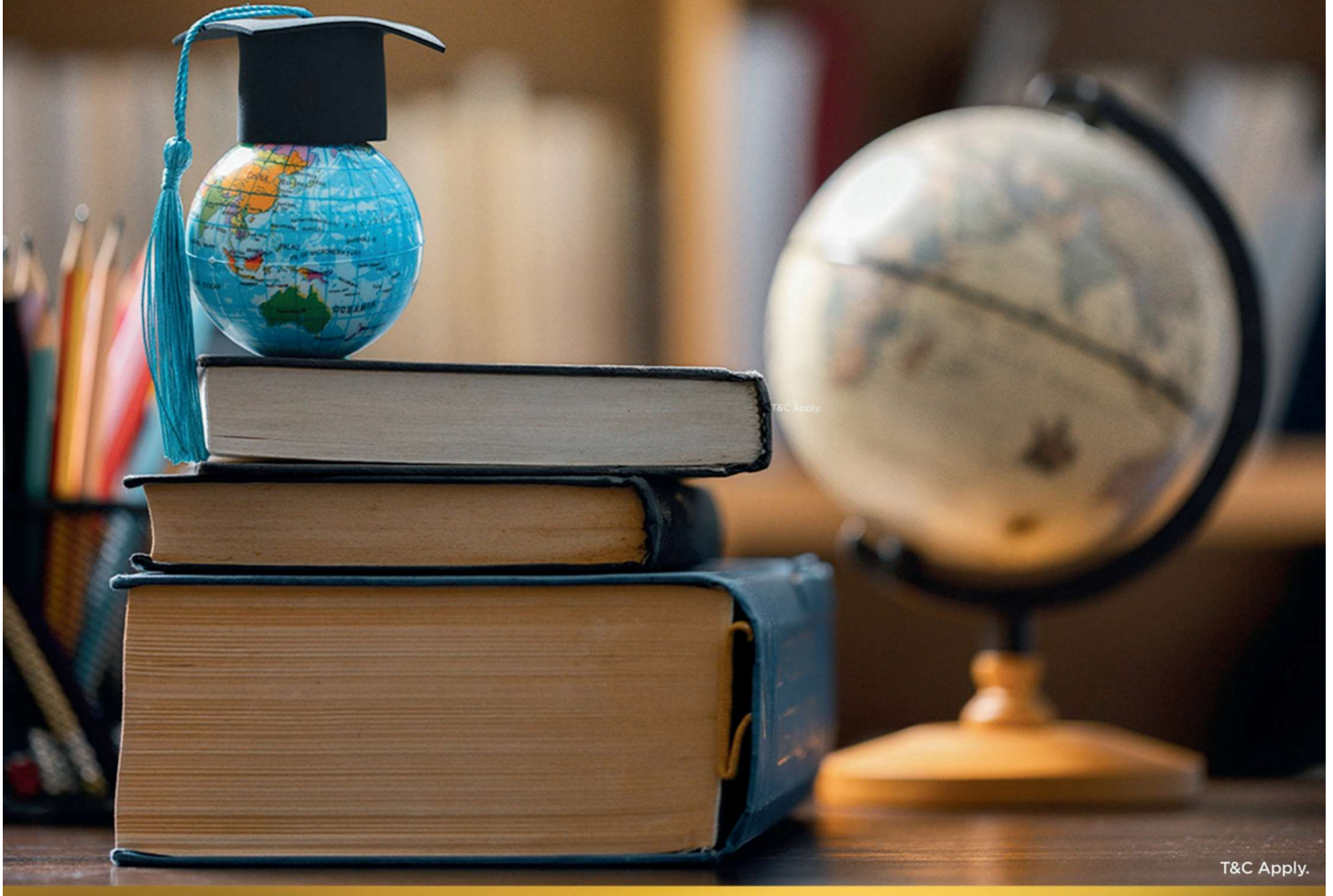
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The Co-lending Ecosystem



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The Co-Lending Ecosystem

Bridging India's Credit Divide

Dec 2025 | Theme 408

"Co-lending is one of the exigencies that was created during Covid by the RBI. The RBI wanted a quick flow of funds to the priority sector and the excluded segment of the country."

Sanjay Sharma, Managing Director, Aye Finance

The 'SIB Students' Economic Forum' is designed to kindle interest in the minds of the younger generation. We highlight one theme in every monthly publication. Topic of discussion for this month is **The Co-Lending Ecosystem**.

Co-lending in India has emerged as a central pillar of the country's credit delivery architecture, especially for retail, MSME, and other under-served segments, by combining banks' low-cost capital with the origination strength and niche expertise of NBFCs and FinTech's. The Reserve Bank of India (RBI) has steadily evolved a detailed co-lending framework from the 2018 co-origination model through the 2020 Co-Lending Model (CLM) to the comprehensive Co-Lending Arrangements (CLA) Directions, 2025, effective from 1 January 2026, which now cover virtually all sectors and impose clearer prudential and customer-protection standards.pwc+3

Below is a compact, structured article that you can easily expand into a longer 4,000–5,000-word piece by elaborating examples, adding case studies, and inserting diagrams or tables for your course material.

Concept and Evolution of Co-Lending

Co-lending refers to a collaborative lending arrangement in which two or more regulated entities (typically a bank and an NBFC, often with a fintech as service provider) jointly extend loans to a borrower, sharing both credit risk and income. The model is designed to marry banks' balance sheet strength and low-cost funds with NBFCs' distribution reach, underwriting expertise in specific segments and geographies, and digital capabilities of fintech partners.



Historically, "co-lending" in India was associated with large-ticket corporate exposures in the form of consortium and syndicated lending, where multiple banks shared a single exposure. The recent co-lending framework, however, targets retail and MSME borrowers, especially in under-served and new-to-credit segments, by allowing granular, standardized sharing of each individual loan between partners.

Regulatory Framework and RBI Directions

The RBI first formalized the concept of joint lending to priority sector borrowers through the 2018 co-origination guidelines, which permitted banks and NBFCs (excluding Housing Finance Companies then) to co-originate loans with a pre-agreed risk-sharing arrangement. This was followed by the 2020 Co-Lending Model (CLM) circular, which broadened co-lending to more NBFC categories, clarified operational expectations, and explicitly promoted the model for achieving Priority Sector Lending (PSL) targets.

A major shift arrived with the **Co-Lending Arrangements (CLA) Directions, 2025, effective from 1 January 2026**, which replace the earlier CLM and create a unified framework for co-lending between regulated entities (REs) across all sectors, not just PSL. The Directions prescribe, among other things, a minimum 10% exposure for each partner per individual loan, time-bound transfer of exposures (usually within 15 days), blended interest rate disclosures, escrow-based cash-flow management, synchronized asset classification and provisioning, and alignment with digital lending standards including Default Loss Guarantee (DLG) caps.



Business Rationale and Strategic Importance

The central policy objective behind co-lending is to improve credit flow to unserved and under-served segments by leveraging complementarities between different types of lenders. Banks bring in stable, low-cost funding and regulatory impetus to meet PSL obligations, while NBFCs bring specialized origination in rural, semi-urban, informal or niche sectors like micro-enterprises, used vehicles, and affordable housing.

For policymakers, co-lending is a tool for financial inclusion and economic formalization, as it can channel formal credit into segments that historically depended on informal lenders or were excluded altogether. For industry participants, it offers capital efficiency, diversification, and the ability to scale portfolios rapidly without each lender independently building distribution and underwriting capabilities across all segments.

Co-Lending Models (CLM-1 and CLM-2)

In practice, two broad co-lending models operate in India, often referred to as CLM-1 and CLM-2 in industry parlance and presentations explaining the RBI framework. While the regulatory Directions focus on principles and outcomes

rather than rigidly prescribing these labels, the two models are widely recognized in the market as operating patterns.

Under the first model (commonly CLM-1), the bank often acts as a principal co-lender from the outset, directly participating in loan origination with the NBFC, with both parties booking their agreed share of each loan on their respective books shortly after sanction. The second model (CLM-2) is more NBFC-led: the NBFC originates and temporarily books 100% of the loan, and subsequently the bank purchases its agreed share on a back-to-back basis within the timeline and conditions stipulated in the master co-lending agreement.

Operational Mechanics and Risk Sharing

A typical co-lending arrangement is governed by a master Co-Lending Agreement (CLA) between partner REs that lays down the risk-sharing ratio, roles and responsibilities, credit policies, pricing formula, servicing obligations, and dispute resolution mechanisms. The RBI Directions require that each lender retain at least 10% of every individual loan on its own books, ensuring that both lenders have adequate “skin in the game” and cannot fully offload risk through the structure.



Customer-facing aspects, including onboarding, documentation, and servicing, are usually handled by a designated “single point of interface” (often the NBFC or fintech partner), although ultimate regulatory responsibility for KYC, credit sanction, and reporting rests with the regulated entities. Collections and repayments are routed through an escrow account with predefined waterfall rules that allocate principal, interest, fees, and charges to each lender in accordance with the agreed share and blended pricing mechanism.

Key Regulatory Requirements under CLA 2025

The CLA Directions 2025 introduce a range of prudential and conduct requirements intended to standardize and de-risk co-lending across the system. Some of the prominent features include:

- **Minimum 10% exposure:** Each partner RE (bank or NBFC) must retain at least 10% share in each individual co-lent loan on its own books, a reduction from the earlier 20% minimum but now applicable to both parties.
- **Time-bound transfer:** In NBFC-led models, partner lenders must bring the loan onto their own books on a back-to-back basis within a defined

period, typically 15 calendar days from disbursement, failing which the originator may have to retain full exposure or treat the loan as its stand-alone asset.

Other crucial requirements relate to credit assessment, customer disclosures, and asset classification. Both lenders must perform ex-ante due diligence and cannot outsource the core credit sanction decision, although third parties can support with data and analytics subject to conditions. Asset classification is to be synchronized at the borrower level, meaning if one lender tags an account as SMA or NPA, other co-lenders must mirror the classification and adjust provisioning accordingly.

Blended Interest Rate and Customer Disclosures

One of the hallmark customer-centric aspects of the co-lending framework is the requirement to charge borrowers a single blended interest rate, even though different lenders fund different proportions of the loan at their own internal pricing. The blended rate is generally the weighted average of each partner's lending rate for its share, and is the rate disclosed and charged to the borrower in the loan documentation.

The RBI framework further mandates detailed disclosures in the Key Fact Statement (KFS), which must clearly outline the effective interest rate, fees and charges, and any third-party service charges, which are excluded from the blended interest calculation but must be transparently communicated. The Directions also align co-lending with digital lending norms, including caps and conditions for Default Loss Guarantees (DLGs), typically up to 5% at the pool level, which can be provided by third parties or FinTechs subject to strict conditions.



Roles of Banks, NBFCs and FinTechs

Banks are usually the dominant funding partners in co-lending deals, providing the bulk of the capital at lower cost due to their access to retail deposits and stronger balance sheets. Co-lending enables them to extend their reach into granular retail and MSME segments with limited incremental branch and manpower investment, while also helping meet PSL targets more efficiently.

NBFCs typically act as front-end originators with strong local presence, sectoral specialization, and agile underwriting, especially in rural, semi-urban, and niche product categories. For NBFCs, co-lending offers access to cheaper funds and the

ability to scale assets while managing leverage, as a portion of every loan is funded by partner banks rather than only from NBFC balance sheets.

FinTechs often play a non-lending but critical role as technology and service partners, providing loan origination systems, underwriting algorithms, data integrations, eKYC, document management, and servicing platforms that enable real-time sharing of information between co-lenders and seamless digital journeys for customers. Some FinTechs may also provide DLGs or act as collection and analytics partners, subject to RBI's digital lending and DLG guidelines.

Technology Infrastructure and Process Integration

Effective co-lending requires a robust technological backbone that can support joint underwriting, real-time data exchange, and complex servicing and reconciliation. Typical architecture includes integrated loan origination systems (LOS), loan management systems (LMS), API-based connectivity between banks, NBFCs and FinTechs, as well as dedicated co-lending modules capable of maintaining each lender's share, risk metrics, and accounting entries.



The RBI's emphasis on escrow-based cash-flow management and borrower-level asset classification synchronization further elevates the need for strong systems that can process repayments, allocate funds across lenders, generate accurate MIS, and ensure timely reporting to credit

information companies (CICs) by each RE. Modern co-lending platforms increasingly incorporate rule engines for automated eligibility checks, pricing, and partner allocation, as well as analytics dashboards for monitoring vintage performance, delinquencies, and partner-level portfolios.

Benefits for Stakeholders

The co-lending framework delivers distinct benefits to each class of stakeholders when implemented properly. Key advantages include:

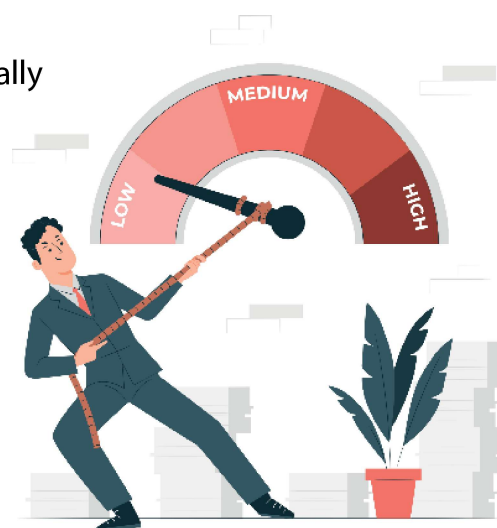
- For banks:
 - Expanded access to new customer segments without heavy investment in physical distribution or specialized underwriting teams.
 - Efficient achievement of PSL targets and better diversification of retail credit portfolios by leveraging NBFC channels.

- For NBFCs:
 - Access to lower cost of capital, enabling more competitive pricing to end-borrowers and better margins.
 - Ability to scale AUM rapidly with a lower balance-sheet footprint, as part of each loan is funded by banks and not entirely by NBFC's own borrowings.

- For borrowers and the economy:
 - Wider availability of formal credit at relatively lower interest rates than informal lenders, particularly in rural and semi-urban markets.
 - Increased financial inclusion, sectoral growth (e.g., MSME, agriculture, affordable housing), and job creation through improved credit access.

Challenges and Risk Factors

Despite its potential, co-lending is operationally complex and subject to several risk factors which RBI and market participants are actively trying to address. Typical challenges include misalignment of credit policies, differing risk appetites, and disagreements over underwriting standards between partner lenders, which can result in friction in approvals and portfolio quality over time.



Technology integration gaps and data-sharing issues can also create reconciliation difficulties, delayed reporting, and inconsistent asset classification if not properly addressed through comprehensive SLAs and API-based platforms. On the customer side, lack of awareness about co-lending, confusion about who the lender really is, and negative perceptions about collection practices can lead to borrower distrust if the model is not executed with clear communication and consistent service standards.

Risk Management, Governance and Compliance

To make co-lending sustainable, both banks and NBFCs need strong risk management and governance frameworks specific to these partnerships. This includes aligning credit policies, agreeing on deviations and exception-handling protocols, defining ownership for monitoring, early warning signals, and collection strategies, and setting thresholds for performance-based recalibration of risk-sharing ratios.

Compliance requirements are extensive, covering KYC, AML/CFT controls, fair lending practices, grievance redressal, data protection, and adherence to digital

lending and DLG norms, with each RE remaining individually responsible to the RBI for its obligations. Governance mechanisms include joint steering committees, periodic partner audits, portfolio reviews, and detailed MIS and dashboards that track delinquencies, roll rates, partner-wise performance, and recovery outcomes at granular levels.

Data Protection, PDPL and Customer Protection Concerns



As co-lending relies heavily on data sharing between multiple entities, concerns around data privacy, consent, and secure processing have become more prominent. Customers' personal and financial data often flows between banks, NBFCs, fintech platforms, and sometimes DLG providers or analytics vendors, increasing the attack surface and the need for robust data protection controls.

The regulatory environment is moving towards stricter data protection obligations, including sector-neutral data protection laws and RBI's expectations on confidentiality, purpose limitation, and secure storage and transmission of data in outsourcing and digital lending arrangements. Co-lenders therefore must implement strong information security frameworks, obtain explicit customer consent for data sharing, and ensure that contracts with third-party service providers stipulate clear responsibilities and liabilities for data breaches or misuse.

Market Size, Growth Trends and Use Cases

Co-lending has grown rapidly in recent years, with estimates indicating that the industry disbursed around INR 47,000–52,000 crore in FY23 and is projected to grow multiple times over the next five years as more banks, NBFCs and FinTechs adopt the model. Growth is particularly strong in segments such as MSME loans, consumer durable finance, affordable housing, gold-backed loans, and vehicle finance, where NBFCs historically have strong franchises and co-lending enables bank participation at scale.

Several notable partnerships have emerged between large private and public sector banks, leading NBFCs, and digital lenders, with many using sophisticated technology stacks to manage end-to-end co-lending workflows. As RBI's new CLA

Directions take effect from 2026, the model is expected to become more standardized and transparent, potentially paving the way for more complex structures such as multi-RE co-lending pools and capital markets takeout of co-lent assets.

Future Outlook and Strategic Themes

The future of co-lending in India will be shaped by three broad themes: regulatory evolution, technology innovation, and competitive dynamics. The CLA 2025 framework signals RBI's intent to mainstream co-lending beyond PSL while tightening prudential and conduct norms, suggesting that compliance, transparency, and customer protection will remain central to any further changes.

On the technology front, advancements in AI-driven underwriting, alternative data, account aggregators, and real-time analytics can further reduce information asymmetry and improve risk-based pricing in co-lent portfolios. Competitive dynamics are likely to push banks and NBFCs to form selective, strategic partnerships rather than purely transactional ones, with emphasis on long-term alignment, portfolio performance, and differentiated customer propositions instead of just balance sheet growth.

Practical Implications for Practitioners in India

For professionals in compliance, risk, and product roles, co-lending necessitates a detailed understanding of RBI guidelines, partner agreements, and operational risks. Key practical tasks include designing co-lending products aligned with partner policies, preparing detailed SOPs for origination and collections, configuring LOS/LMS to handle multiple lenders' shares and accounting, and implementing robust monitoring frameworks.

From a governance perspective, boards and senior management must treat co-lending portfolios as distinct risk buckets, track them through dedicated metrics, and integrate them into the institution's overall credit risk appetite, stress testing, and capital planning. Customer-facing teams must be trained to explain co-lending structures, handle grievances, and ensure uniform treatment of borrowers irrespective of which co-lender ultimately books what share of the loan, preserving the integrity of the customer relationship.

If you want, a next step can be a detailed 4,000–5,000-word course-ready chapter with subheadings, sample clauses from a Co-Lending Agreement, and exam-style questions tailored to Indian banking and compliance exams.

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