

## Co-origination lending: A potential solution to NBFCs' funding challenges

Rs.25,000 Cr. additional lending to microfinance and MSMEs expected over the medium term

Acuite Ratings believes that the RBI guidelines on co-origination of priority sector loans by NBFCs and banks is a significant step towards an efficient framework for microfinance and MSME lending in India. Acuite estimates Rs.25,000 -30,000 Cr. of potential lending every year under this origination mechanism over the medium term. In the opinion of Acuite, a part of the volumes currently undertaken by loan assignments from NBFCs to banks under the securitisation framework is likely to be routed through co-origination. NBFC-MFIs and mid-sized NBFCs focusing on the MSME segment will be the key beneficiaries given their focus on customer segments which qualify for priority sector classification. Banks, especially public sector banks (PSBs), will also benefit from the origination of good quality but relatively higher yield retail loans, thereby helping them meet their priority sector lending requirements while enhancing the diversity in their loan portfolio. This will further promote financial inclusion through better reach and access of borrowers to lower interest rates (weighted average) on the co-originated loans.

NBFCs focused on micro finance and MSME lending have strong business growth potential over the medium to long term and hence require continued funding support. NBFCs are primarily dependent on debt markets, bank loans and securitisation (also to banks) to meet their funding requirement. Only large and highly rated NBFCs have access to the debt markets where conditions are not currently favourable. Public sector banks, especially under the PCA framework, are reaching the single borrower and overall NBFC sector exposure limits and hence are unable to meet their funding requirements. Many NBFCs, especially mid-sized, therefore face funding challenges which is constraining their growth opportunities. Additionally, the rising interest rate scenario, means an increase in the funding cost of the NBFCs. **Says Suman Chowdhury, President, Acuite Ratings "Co-origination of eligible priority sector loans will provide a good avenue to NBFCs to grow their assets under management without facing any funding related challenges or capital constraints. To be sure, NBFCs are not new to the co-origination business model as they have been partnering with banks in various forms for loan origination except that there was some form of loss-sharing arrangement, which is not permitted under the current guidelines. This framework is relatively more transparent as compared to loan assignments under securitisation guidelines and will facilitate healthy growth of priority sector loans originated by NBFCs."**

The co-origination mechanism also gives the banking sector another avenue to meet their priority sector lending (PSL) requirements which include securitisation (pass-through certificates and direct loan assignments), priority sector lending certificates (PSLCs), business correspondent or BC model, apart from direct lending.

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**Says Manish Saraf, Head-Financial Sector Ratings, Acuite Ratings “This is an attractive opportunity for banks to originate retail and MSME portfolios consistent with their risk appetite while benefitting from the NBFCs’ sourcing and collections expertise. This mechanism will help banks to look at PSL from a business perspective rather than from a statutory requirement and ensure a sustainable growth of the priority sector advances which stood at Rs. 25.5 lakh Cr as on March 31, 2018.”**

Co-origination, however, will necessitate significant groundwork from both the bank and the NBFC before it takes off. Both need to work on a mutually acceptable sourcing and credit policy which must be also approved by their boards. They will need to enter into a tri-partite agreement with each borrower and have a separate account to monitor the funds movement under this model. Acuite, therefore believes that any significant scale-up of the co-origination model is likely only over the next two years.

### **About Acuite Ratings & Research:**

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