

JUNE 09, 2023

ABOUT THE FIRM

AKS Partners (formerly known as A.K. Singh & Co) is a law firm based in New Delhi (India) that provides a comprehensive range of legal services and solutions to domestic and international clients. The Firm offers a unique blend of the local knowledge to apply the regulatory, economic, political and cultural context to legal issues and develop case strategies.

We regularly handle technically challenging and complex multi-jurisdictional matters. Our team is spearheaded by one of the highly recognised lawyers with extensive experience in international dispute resolution and strong government and diplomatic backgrounds. This experience gives us the deepest understanding of the key decision points that are critical in navigating complex & complicated matters and managing government regulations.

Guidelines on Default Loss Guarantee (DLG) in Digital Lending

The Reserve Bank of India (the '**RBI**') vide circular dated June 08, 2023 ("**Guidelines**") has finally permitted, subject to certain requirements, the arrangement of the Default Loss Guarantee ("**DLG**") between Regulated Entities ("**REs**") and Lending Service Providers ("**LSPs**") or between two REs in Digital Lending.

I. DEFINITION OF DLG

The Guidelines has now defined DLG. In simpler terms, it is a contractual arrangement between REs (such as banks and NBFC) and LSPs or two REs under which the latter agree to compensate the former up to a certain amount in case of losses due to defaults of loan portfolios of REs while undertaking Digital Lending. RBI has further clarified that DLG arrangement confirming to the Guidelines shall not be treated as 'synthetic securitization' and also shall not attract the provision of 'loan participation'.

II. KEY REQUIREMENTS AND HIGHLIGHTS OF THE GUIDELINES

A. Applicability

The Guidelines are only applicable to such DLG arrangements entered into by the REs while undertaking Digital Lending operations pursuant to Digital Lending Guidelines as issued by RBI on September 02, 2022.

B. Eligibility

For the purpose of entering into a DLG arrangement, the RE shall have an existing outsourcing arrangement with the LSP/ other RE.

C. Upfront Agreed DLG Arrangement

As per the Guidelines, the DLG arrangement must be agreed upfront between the RE and the DLG provider in form of legally enforceable contract which among other things shall contain details such as extent of DLG cover, form of DLG, timeline for invocation of DLG and disclosure requirements. The Guidelines further laid down the accepted form of DLG which are (a) cash deposited with the RE; (b) Fixed deposit in favour of RE; and (c) Bank Guarantee in favour of RE.

D. Cap and Invocation of DLG

Perhaps this is one of the most important provision in the Guideline that, the DLG cover shall not exceed 5% of the amount of the relevant loan portfolio. Furthermore, the Guideline also provides that the RE must invoke the DLG within a maximum overdue period of 120 days, unless made good by the borrower before that.

E. Recognition of NPA

The NPA classification of the loan portfolios shall be as per the extant asset classification and provisioning norms, irrespective of DLG cover and the amount of DLG invoked shall not be set off against the underlying individual loan portfolio. Furthermore, as per the Guidelines, any recovery by the RE from the loan portfolio where DLG has been invoked and realised, can be shared with the DLG provider pursuant to upfront contractual arrangement.

F. Tenure

The DLG agreement shall remain in effect as long as the longest loan term in the loan portfolio.

G. Disclosure

The Guideline requires the REs should ensure that LSPs should publish on their website the total number of portfolios and the respective amount of each portfolio on which DLG has been offered.

H. Due Diligence

- REs should put in place a Board approved DLG policy which at minimum shall capture the eligibility criteria for DLG provide, nature, form and extent of DLG cover, details of the fees etc.
- REs should undertake to obtain adequate information from the DLG provider to satisfy itself that DLG provider would be able to honor the arrangement such as declaration certified by the statutory auditor of the DLG provider containing the aggregate DLG amount outstanding, number of REs and the respective number of portfolios against which DLG has been provided.
- Any DLG arrangement shall not be treated as a substitute for credit appraisal requirements.

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AWARDS & RECOGNITIONS



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