

Guidelines on Default Loss Guarantee in Digital Lending

The Reserve Bank of India has issued a circular dated June 8, 2023 ([available here](#)), providing for guidelines on default loss guarantees (“**DLG**”) in digital lending undertaken by regulated entities. The key aspects are set out hereunder:

- **What is a DLG:** DLG is a contract of guarantee, where the guarantor agrees to compensate the lender upto a certain percentage of loss due to default in repayment. A DLG must be a contract where a regulated entity (being banks and NBFCs) (“**RE**”) is furnished a guarantee (including an implicit guarantee) by a lending service provider (“**LSP**”) or any other RE. An LSP is an agent of an RE, to whom one or more functions of the lender has been outsourced.
- **DLG Contract:** The contract should, *inter alia*, include:

Clause	Details
DLG Cover	Should not exceed 5% of the amount of such loan portfolio
Form of DLG	In cash / lien-marked fixed deposits / bank guarantee
Timeline for Invocation	Within a maximum overdue period of 120 days
Disclosure Requirements	Mechanism to ensure that LSPs publish portfolio details on their website
Tenor	Should not be less than the longest tenor of a loan in the portfolio

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- **Recognition of NPA:** RE continues to be responsible for recognition of loans covered by DLG as non-performing assets. RE's are not permitted to set off the amount of DLG invoked against the underlying loans. Subsequent amounts recovered from the borrower, after invocation of DLG, may be shared with the DLG provider as per the DLG contract.
- **Due Diligence:** RE's must comply with the following:
 - Adopting a board approved policy for DLGs including eligibility criteria, nature and extent of DLG, monitoring and review systems, and fees;
 - Implementing robust credit underwriting standards, which are required irrespective of the DLG cover;
 - Satisfying itself that the DLG can honour the contract. Accordingly, each DLG contract must be subject to an appraisal basis information sought from the DLG, and a declaration certified by the DLG's statutory auditor.
- **Exemptions:** The following are not considered to be DLG: (i) Guarantee schemes of Credit Guarantee Fund Trust for Micro and Small Enterprises; (ii) Credit Risk Guarantee Fund Trust for Low Income Housing / individual schemes under National Credit Guarantee Trustee Company Limited; and (iii) Credit guarantee provided by Bank for International Settlements (BIS), International Monetary Fund (IMF) as well as Multilateral Development Banks.