A thumbnail guide to loans & secured financing in India

India | August 22 2019

General framework

Jurisdictional pros and cons

What are the primary advantages and disadvantages in your jurisdiction of incurring indebtedness in the form of bank loans versus debt securities?

It is fairly common among Indian corporates to incur indebtedness through a mix of debt securities and bank loans. Debt securities are usually in the form of debentures, bonds and commercial papers sourced through a public or private issuance.

The advantages of bank loans over debt securities are:

- public issuances of debt securities are heavily regulated compared to bank loans;
- bank loans are usually cheaper compared to debt securities, depending on the profile of the borrower;
- issuance of most debt securities are subject to additional compliances to be adhered to by the borrower under company law;
- it is quicker and less costly to amend bank loan documentation; and
- bank loans provide various types of facilities.

In contrast, it is relatively easier for Indian corporates to raise financing through debt securities as the investor appetite and profiles are not as conservative and rigid as compared to banks.

Forms

What are the most common forms of bank loan facilities? Discuss any other types of facilities commonly made available to the debtor in addition to, or as part of, the bank loan facilities.

Various working capital limits are typically provided to borrowers, along with the traditional term loan credit facility. These working capital facilities usually include:

- letters of credit;
- bank guarantee facilities;
- overdrafts;
- revolving credit lines;
- working capital demand loans;
- buyer's credit; and
- supplier's credit.

Most of the non-fund-based working capital facilities are provided as sub-limits to the term loan. The fund-based working capital facilities are provided for short periods that are regularly renewed.

Investors

Describe the types of investors that participate in bank loan financings and the overlap with the investors that participate in debt securities financings.

Indian corporates have traditionally raised debt from banks and non-banking financial companies. However, the past few years has seen a huge influx of investors financing corporates through debt securities. These include various fund houses, asset-management companies, institutional investors, among others.

How are the terms of a bank loan facility affected by the type of investors participating in such facility?

The terms of a loan vary from investor to investor. Traditional banks are stringent with their documentation and do not agree to many deviations. This is due to their internal policies, which restrict them from being very flexible in negotiations.

Non-banking financial companies, fund houses, institutional investors and asset-management companies usually subscribe to debt securities of the borrowing entity instead of providing a traditional term loan. These investors tend to be more flexible in their terms for lending and may not insist on the standard onerous provisions which a traditional bank might.

Banks are also permitted to sell bank loans to asset-reconstruction companies or securitisation companies, which are, in turn, permitted to securitise the acquired debt and sell it to qualified institutional buyers, including banks, insurance companies and foreign institutional investors. The terms for these loans are usually similar to the initial bank loans.

Bridge facilities

Are bank loan facilities used as 'bridges' to permanent debt security financings? How do the structure and terms of bridge facilities deviate from those of a typical bank loan facility?

Bridge loans are often granted by banks as short term loans to meet liquidity requirements or finance ancillary debts, such as loans for repayment of interest, and meeting immediate working capital requirements. The terms of such loans are not as onerous as compared to a typical term loan. Bridge loans generally have shorter maturity periods and higher interest rates.

Role of agents and trustees

What role do agents or trustees play in administering bank loan facilities with multiple investors?

In India, a lending consortium usually appoints the bank with the largest exposure as the lead bank. Other banks in the consortium provide the lead bank with the rights to represent and manage the group of lenders. Usually the lead bank is provided with all rights of enforcement and to provide directions to obligors. The role of the lead bank is similar to that of a facility agent or a security trustee.

A facility agent is usually appointed for a syndicated lending transaction which adopts the Asia Pacific Loan Market Association (APLMA) facility documentation. Indian law does not restrict a facility agent to act on behalf of the syndicate members. Some Indian banks act in the dual capacity of facility agent and lender.

There are no specific regulations with respect to syndication or consortium lending and lenders are free to structure facilities as agreed by all parties which are within the regulatory framework for lending. However, the Reserve Bank of India (RBI) has directed all banks engaged in consortium or multiple banking arrangements to regularly share credit information of respective borrowers with one another to ensure transparency and reduce fraud among lenders.

The Indian Trust Act 1882 recognises the concept of trusts. A trust is settled in favour of the security trustee who in turn holds the security interest for the benefit of the syndicate lenders. Appointing a security trustee is very common for syndicate financing transactions as a statutory fiduciary duty is attached to the obligations of a trust. The security documents are held in the custody of the security trustee and the security trustee acts on the directions of the syndicate lenders or facility agent (acting on the instructions of the lenders) to enforce the security. However, a recent Supreme Court judgment on the payment of stamp duty on security documents involving a security trustee has created issues for borrowers who are required to bear significant additional stamp duty in syndicated transactions originating in a few states in India.

Role of lenders

Describe the primary roles and typical fees of the financial institutions that arrange and syndicate bank loan facilities.

Financial institutions acting as mandated lead arrangers in transactions typically negotiate and structure the terms of the various facilities that the borrower may be offered, underwrite the commitments and negotiate and appoint a legal counsel to prepare the transaction documents. They are also responsible for arranging other lenders willing to participate in the lending. The terms as agreed by the arranger are typically not renegotiated by syndicate lenders.

The arrangers usually charge fees. These are either in the form of arranger fees, commitment fees or processing fees. These fees are usually non-refundable and payable immediately upon acceptance of the term sheet or execution of the loan agreement. The fees are sometimes paid out of the loan proceeds.

Governing law

In cross-border transactions or secured transactions involving guarantees or collateral from entities organised in multiple jurisdictions, which jurisdiction's laws govern the bank loan documentation?

Facility documentation is usually governed by English law or the jurisdiction where the lender is incorporated for cross-border lending transactions. However, security documents are governed by Indian law if the assets over which the security interest is created are situated in India.

Indian law is used for wholly domestic financing transactions.

Regulation

Capital and liquidity requirements

Describe how capital and liquidity requirements impact the structure of bank loan facilities, including the availability of related facilities.

The RBI requires lending institutions to maintain capital adequacy ratios and leveraged ratios at specific rates and further conform to exposure norms issued by the RBI from time to time. The imposition of these capital requirements affect the bank's ability to effectively lend in the market. During the economic recession of late 2000s, RBI took a stringent approach with respect to capital and liquidity requirements that banks had to maintain. However, with time, these norms were relaxed with the intention to harmonise them with the Basel III norms. Even so, the RBI capital adequacy percentage is stricter than the existing Basel III requirement. The RBI is also yet to implement its framework on the total loss absorbing capacity and on the revised Pillar 3 disclosure requirements as required under the Basel III norms. Usually related working capital facilities, either fund- or non-fund-based are provided in the form of sub-limits to the main term loan and do not get affected by the above norms.

Disclosure requirements

For public company debtors, are there disclosure requirements applicable to bank loan facilities?

Public listed entities are required to make certain disclosures to the stock exchanges where their securities are listed in relation to certain secured debt obligations. The regulator has also mandated debenture trustees and other parties related to the issuance of debt securities must make certain additional disclosures to the public and to each other. Specific disclosures are also required to be made by listed entities in the event of default in the payment of interest or instalments on any loan or debt securities. Further, an offer document of a company issuing securities to the public must include an auditor's report, mentioning the principal terms of loan and assets charged as security as well as the total outstanding unsecured loans and their terms, taken by the issuer company, its promoters, group companies, and associate companies. Indian company law requires a public company to obtain the approval from its shareholders when the total borrowings of the company (apart from temporary loans) exceeds its paid up share capital, free reserves and securities premium. The extracts of all shareholder meetings are required to be disclosed to the Registrar of Companies which becomes a public document. The Insolvency and Bankruptcy Code imposes a further obligation on financial creditors to disclose information pertaining to the loans provided to corporates to the Information Utility.

Use of loan proceeds

How is the use of bank loan proceeds by the debtor regulated? What liability could investors be exposed to if the debtor uses the proceeds contrary to regulations? Can investors mitigate their liability?

Loans issued by banks are regulated under the Banking Regulation Act 1949, and various directions and regulations issued by the RBI from time to time. There are multiple restrictions imposed on banks for granting of loans (eg, certain restrictions on acquisition financing). Banks are obligated to conform with the know your customer guidelines and monitor transactions with borrowers.

Under the know your customer guidelines, banks are required to conduct ongoing due diligence of borrowers and their businesses and source of funds. The types of activities that should be mandatorily monitored are:

- large and complex transactions including:
  - large fund transfer transactions;
  - those with unusual patterns inconsistent with the normal and expected activity of the customer; and
  - those with no apparent economic rationale or legitimate purpose;
- transactions that exceed the thresholds prescribed for specific categories of accounts;
- high account turnover inconsistent with the size of the balance maintained; and
- deposit of third-party cheques, drafts in existing and newly opened accounts followed by cash withdrawals for large amounts.

Banks are also required to introduce a system of maintaining proper record of transactions in accordance with the provisions of the Prevention of Money Laundering Act 2002 and the rules thereunder.

Banks are also required to adhere to the provisions of the Unlawful Activities (Prevention) Act 1967, which require banks to ensure that they do not have any account in the name of individuals or entities appearing in the lists of individuals and entities suspected of having terrorist links, which are approved by and periodically circulated by the United Nations Security Council.

In the event of a non-compliance of the above mandatory requirements, a monetary penalty may be imposed by the RBI. In some cases, a bank may be forced to forfeit its licence. Loan documentation usually provide protections to the lenders where the borrowers provide specific sanctions related representations and warranties, and undertakings that are backed up by indemnities. The declaration from the borrower is usually to the effect that there are no sanctions imposed on the borrower and its affiliates, and the borrower has no dealing with any person on whom sanctions have been imposed. The sanction authority is usually referred to the Office of Foreign Assets Control, RBI or any other regulatory authority in India, United Nations and European Union.

Cross-border lending

Are there regulations that limit an investor's ability to extend credit to debtors organised or operating in particular jurisdictions? What liability are investors exposed to if they lend to such debtors? Can the investors mitigate their liability?

The Overseas Direct Investment Regulations issued by the RBI imposes certain limitations on Indian residents, including banks, investing in Pakistan, Nepal and Bhutan. The RBI strictly regulates banks from entering into transactions with countries which do not, or insufficiently, apply the Financial Action Task Force (FATF) recommendations. Specific safeguards are put in place while transacting with entities in these countries.

Indian entities are also restricted to borrow funds from entities which are not from FATF-compliant countries. 'FATF-compliant country' refers to a country that is:

- a member of FATF or a member of a FATF-style regional body; and
- is not a jurisdiction that:
  - is identified in the FATF's public statement as having strategic anti-money laundering or combating the financing of terrorism deficiencies to which countermeasures apply;
  - has not made sufficient progress in addressing deficiencies; or
  - has not committed to an action plan developed with FATF to address such deficiencies.

Similar representations and warranties, undertakings and indemnities as mentioned in question 11 are also obtained.

Debtor's leverage profile

Are there limitations on an investor's ability to extend credit to a debtor based on the debtor's leverage profile?

There are no such statutory limitations imposed on banks. However, the RBI has issued an extensive set of guidelines to determine the credit risks involved in loan transaction and risk mitigation methods. The different types of risks are categorised as:

- credit;
- interest rate;
- foreign exchange rate;
- liquidity;
- equity price;
- commodity price;
- legal;
- regulatory;
- reputational; and
- operational.

The guidelines provide for a system of credit risk management in the following manner:

- establishment of a credit approving authority;
- prudential limits to be imposed on various aspects of credit;
- standardised risk rating system;
- risk pricing system;
- portfolio management for gauging asset quality; and
- loan review mechanism.

Interest rates

Do regulations limit the rate of interest that can be charged on bank loans?

The RBI prescribes the marginal cost of funds-based lending rates (MCLR), which is the minimum rate of interest that a bank may charge for lending. The spread, which is in addition to MCLR, is at the discretion of the lender. However, the RBI has required banks to have a board-approved policy delineating the components of spread charged to a customer. The policy should include principles to:

- determine the quantum of each component of spread;
- determine the range of spread for a given category of borrower or type of loan; and
- delegate powers in respect of loan pricing.

Loans raised by Indian entities from foreign investors have restrictions on the maximum amount of interest that can be charged. Currently the all-in-cost for certain types of external commercial borrowing is capped at six-month LIBOR plus 4.5 per cent.

Currency restrictions

What limitations are there on investors funding bank loans in a currency other than the local currency?

Bank loans are generally issued to borrowers in the local currency. Indian residents are generally not permitted to hold bank accounts in foreign currencies, other than foreign exchange earners, etc. However, Indian banks leverage their foreign exchange treasury holding and provide loans in the nature of foreign currency non-resident loans to Indian corporates. These are primarily provided for meeting import requirements of the Indian entity and are generally cheaper than raising loans in rupees. However, the Indian entity is required to hedge their exposure which has additional costs attached to it.

Indian companies may raise loans from the foreign markets for funding in the form of External Commercial Borrowings (ECBs). In such cases, the inward remittance is retained by the bank in the foreign exchange and to that extent is lent to the borrower in the domestic currency. However, if the ECB is designated in a foreign exchange, the repayment would need to happen in the same currency the loan was availed in. Loans raised under ECB regulations are subject to certain restrictions. Certain ECBs cannot be used for investment in the real-estate sector, repayment of existing rupee loans, or in domestic equity investments.

Other regulations

Describe any other regulatory requirements that have an impact on the structuring or the availability of bank loan facilities.

RBI comprehensively regulates the lending activities of banks in India. Illustrations of few regulatory restrictions are:

- exposure limits on lending to the same group;
- restriction on lending to directors and their relatives of the bank;
- threshold limits on holding shares (including by way of pledge) in other companies;
- restrictions on lending against the bank's own securities; and
- restrictions on lending to entities which harm the environment.

Indian exchange control laws imposes certain restrictions on foreign-owned and -controlled companies from raising finance in the domestic market for the purposes of downstream investment.

Security interests and guarantees

Collateral and guarantee support

Which entities in the organisational structure typically provide collateral and guarantee support for bank loan financings? Are there limitations on which entities in the organisational structure are permitted to provide such support?

Typically, the company with the longest credit history and most assets in a group structure provides the collateral and guarantee support. This may be the parent, subsidiary or an associate company of the primary borrower.

The Companies Act 2013 restricts the issuance of guarantees by companies to guarantee loans taken by any director of the company or any other person in whom the director is interested. However, the law provides for practical exemptions to this rule, whereby a holding company may provide a guarantee or security for a loan taken by a wholly owned subsidiary or a loan taken by a subsidiary from a bank or financial institution, provided that the loan is utilised by the wholly owned subsidiary or subsidiary for its principal business activities. The law has been further liberalised to permit companies to issue a guarantee towards a borrowing by any person in whom a director is interested by seeking approval from the company shareholders through a special resolution, provided that the loan is used for the principal business activities of the borrower. The Companies Act also prescribes limits on the guarantees that can be issued.

Guarantees provided by Indian companies as credit support towards loans taken by their overseas subsidiaries must be reported to an authorised dealer bank. These guarantees need to be capped at 400 per cent of the net worth of the guarantor and should have a specific expiry. The approval of the RBI will be required for providing a guarantee beyond the stipulations.

Payment of stamp duty on the deed of guarantee is necessary to ensure enforceability of the guarantee document in a court in India.

The ECB guidelines permit the creation of security or granting of guarantees in favour of foreign lenders to extend credit support for the lending, by obtaining the approval of the authorised dealer bank. In certain cases, RBI approval is required for creation of the security or providing guarantees.

What types of obligations typically share with the bank loan obligations in the collateral and guarantee support? If so, are all such obligations equally and ratably covered by the collateral and guarantee support?

Derivative transactions typically share the same collateral and guarantee support extended towards a bank loan on a pari passu basis. Depending on the nature of the transaction, derivative transactions may also be secured by a standalone security package.

Commonly pledged assets

Which categories of assets are commonly pledged to secure bank loan financings? Describe any limitations on the pledge of assets.

The assets over which security interest is most commonly created are:

- immovable assets;
- tangible and intangible movable assets (eg, raw materials, receivables, current assets, equipment, furniture and vehicles);
- financial instruments (eg, shares, debentures and bonds);
- cash deposits; and
- intellectual property (eg, copyrights, trademarks and patents).

Limitations extend towards the type of asset being secured. For example, it is not possible to create a mortgage over future assets (however, a charge over future assets may be created through a hypothecation). Third-party approvals may also be required on certain assets (eg, the creation of mortgage over a tenant's leasehold interest over a property may require the consent of the property's owner).

Creating a security interest

Describe the method of creating or attaching a security interest on the main categories of assets.

A security interest over assets is created either by way of mortgage, pledge or hypothecation. It is usually possible to create security interest over almost all assets of an entity. In practice, each type of asset usually requires a different type of security interest to be created. Separate security documents would need to be executed depending on the type of security interest. For example, a security interest by way of equitable mortgage would need its own set of documents (declaration and memorandum of entry) evidencing the creation of the mortgage that will be separate from a hypothecation or pledge.

Perfecting a security interest

What steps are necessary to perfect a security interest on the main categories of assets? What are the consequences of failing to perfect a security interest?

There are different perfection requirements involved for different categories of assets being secured. However, the most common procedures are:

- applicable stamp duty and registration fees must be paid;
- requisite filings with the company registry and information utility under the Insolvency and Bankruptcy Code are required to record the security interest;
- certain lenders are required to register their mortgages with the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI);
- corporate authorisations of the security provider should be in place; and
- all third-party consents are required to be obtained.

Failure to make the filings with the company registry will result in the creditor not being identified as a secured creditor during insolvency and bankruptcy proceedings.

Future-acquired assets

Can security interests extend to future-acquired assets? Can security interests secure future-incurred obligations?

Security interests can be created over future movable property. However, security interests on future immovable property cannot be created prior to the immovable property being acquired by the security provider. Assets can secure future-incurred obligations in India. However, enforcement of these rights is questionable.

Maintenance

Describe any maintenance requirements to avoid the automatic termination or expiration of security interests.

Generally, there are none. However, in instances when a term deposit for a specific duration is placed as security for a debt and the term deposit matures without an automatic renewal provision being present, the security would stand terminated.

Release

Are security interests on an asset automatically released following its sale by the debtor? If so, are the releases mandated by law or contract?

Specific charge satisfaction forms must be filed with the company registry, the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) and information utility under the Insolvency and Bankruptcy Code, if applicable, for releasing security which was recorded with the company registry, CERSAI and information utility, respectively.

A deed of release or reconveyance is entered into between the mortgagor and mortgagee, which is subsequently registered, to release a charge created on an immovable property by way of an English mortgage.

The title deeds must be returned to the mortgagor in case of an equitable mortgage. Where the equitable mortgage is registered in a specific state, a release deed must also be registered with the relevant authority to perfect the release of security.

Pledged share certificates must be returned to the shareholder, if in physical form, upon the release of security. Requisite forms must be filed with the depository participant if the shares are held in dematerialised form.

A deed of release must be executed between the security provider and security holder and filed with the necessary authority to ensure release over intellectual property rights.

The releases are mandated both under law and contract.

Non-fulfilment of guarantee obligations

What defences does a guarantor have against claims for non-fulfilment of guarantee obligations? Can such defences be waived?

The concept of guarantee is governed by the Indian Contract Act, 1872. A guarantor is usually liable to the same extent as the borrower; however, there are exceptions to this general rule. The guarantor may be discharged from liability in the event of variance in the terms of the contract between the borrower and the creditor, without the guarantor's consent. A guarantor may be discharged if the creditor makes a composition with, or promises to give time to, or agrees not to sue, the borrower. Another defence available to the guarantor is when the borrower is discharged from liability due to a contract with the creditor for discharge or due to an omission by the creditor. In this case, since the borrower is discharged of liability, the guarantor too is discharged of the obligations under the guarantee.

These defences are usually specifically waived in the guarantee document.

Parallel debt requirements

Describe any parallel debt or similar requirements applicable in a secured bank loan financing where an agent acts for multiple investors.

There are no such requirements. It is very common for banks to appoint security agents or trustees to safeguard the security in a syndicated loan where multiple investors are involved. For more information, refer to question 6.

Enforcement

What are the most common methods of enforcing security interests? What are the limitations on enforcement?

Asset classification norms by the RBI mandate banks to classify a loan as a non-performing asset and provision for it accordingly if the loan has been in default for a continuous period of 90 days. Banks and specific financial institutions have the right to enforce their security interest without court intervention once the account is classified as a non-performing asset. The procedure for these lenders to enforce without court intervention is laid down under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act 2002. A notice must be provided to the defaulting entity to repay all dues within 60 days of the date of the notice. If the defaulting party fails to make such payment and does not contest the notice, the lenders have the right to take possession of the secured property and auction it to realise its dues. This right of the lenders also extends to third-party security providers. Lenders not covered under the SARFAESI Act must initiate action in accordance with the dispute resolution mechanism laid down in the financing documents.

Security interest created by a hypothecation or pledge has contractual remedies where the lenders may dispose of the assets without the intervention of courts. This is usually practically difficult for hypothecation, as the lenders do not have possession of the secured assets.

Lenders also have the right to initiate insolvency proceedings immediately upon the occurrence of a payment default. RBI has the power to direct banks to initiate insolvency proceedings against a select few debtors. RBI has recently used these powers and identified certain accounts which would need to be referred to insolvency. RBI has also recently changed its stressed asset resolution regulations and instructed banks to commence a resolution process upon the occurrence of a payment default. There are heavy provisioning requirements that the banks need to comply with in the event of failing to timely conclude a resolution plan and refer the account to insolvency.

Fraudulent conveyance and similar doctrines

Describe the impact of fraudulent conveyance, financial assistance, thin capitalisation, corporate benefit and similar doctrines on the structure of bank loan financings.

Fraudulent Conveyance

Under the provisions of the Insolvency and Bankruptcy Code 2016, the liquidator has the power to question certain past transactions (usually up to the past two years from the date of commencement of insolvency proceedings) of the company and make an application to the tribunal to reverse such transactions. These transactions include preferential transactions, undervalued transactions, extortionate credit transactions or fraudulent transactions. For example, if a company disposed of an asset that was undervalued, such a transaction may be reversed by a tribunal, or the debtor must make a payment in favour of, or to the benefit of, a creditor that puts the said creditor in a more beneficial position.

Financial Assistance

There are provisions under the Companies Act 2013 which prohibit public companies from giving financial assistance for the purpose of purchasing or subscribing to its own shares or in its holding company. This does not apply to banks acting in their ordinary course of business. The Banking Regulation Act also restricts banking companies from granting:

- loans and advances on the security of its own shares;
- loans and advances to or on behalf of any of its directors;
- loans and advances to any firm in which any of its directors is interested as partner, manager, employee or guarantor;
- loans or advances to any company or the subsidiary or the holding company of which any of the directors of the bank is a director, managing agent, manager, employee or guarantor, or in which the director holds substantial interest; or
- loans and advances to any individual in respect of whom any of its directors is a partner or guarantor.

Non-compliance with the above restrictions may result in monetary and administrative penalties applicable under the law.

Thin capitalisation

There are no specific debt-to-equity ratios or thin capitalisation rules under Indian law. However, transfer pricing regulations should be adhered to when dealing with group entities.

Corporate benefit

For every guarantee, it is necessary that a consideration is involved. As per the Indian Contract Act 1872, any promise made to the lender by the borrower is sufficient consideration for the guarantor. The Companies Act 2013, contains provisions where a holding company may grant a loan or give any guarantee or provide any security in connection with a loan taken by its subsidiary, provided that the loan is utilised by the borrower for its principal business activities. For more information, refer to question 17.

Intercreditor matters

Payment and lien subordination arrangements

What types of payment or lien subordination arrangements, or both, are common where the debtor has obligations owing to more than one class of creditors?

The priority of debts is usually set by contractual arrangements between the creditors. An intercreditor agreement is entered into between the various creditors which provides for structuring the priority of repayment obligations. Banks that have arranged the facility and taken the largest exposure usually demand priority status in an enforcement scenario. This also depends on the ranking of security interest created on the assets of the obligor. A company that has created a security interest over its assets is required to file certain forms with the Ministry of Corporate Affairs (Company Registry) in India. The filing of the security interest with the company registry determines the priority of ranking of the charge of various lenders, other than those otherwise contractually agreed.

Most lenders typically insert a clause in their facility documentation which ensures that their payment obligation would rank at least pari passu with the claims of all other unsecured and unsubordinated creditors of the obligor.

Lenders can also vary any statutory dues by the obligor, as these dues take priority over a secured creditor, other than in an insolvency proceeding. A certificate from an income tax officer is usually requested, which waives the statutory lien of the Income Tax Department against the particular asset over which a security interest is created for recovery of income tax dues. This certificate is valid for 180 days from the date of issuance. Another certificate can be applied for and obtained on the expiry of the earlier certificate.

The contractual arrangements between creditors cannot supersede the provisions of the Insolvency and Bankruptcy Code listing down the payment priority in a liquidation.

Creditor groups

What creditor groups are typically included as parties to the intercreditor agreement? Are all creditor groups treated the same under the intercreditor agreement?

Most secured creditors, irrespective of their outstanding amounts, are usually party to an intercreditor agreement. The creditors generally agree among themselves on the voting rights and the structure of repayment to be adopted. However, in practice, creditors with a majority outstanding will have more voting percentage compared to junior creditors. Recently most Indian banks foreign banks and financial institutions signed an intercreditor agreement laying down the procedure to be followed for realisation of debt amount in the event of insolvency. It was agreed that the resolution plan approved by majority lenders would be final and binding on all other lenders.

Rights of junior creditors

Are junior creditors typically stayed from enforcing remedies until senior creditors have been repaid? What enforcement rights do junior creditors have prior to the repayment of senior debt?

There are no restrictions under Indian laws that curb the right of a junior creditor to initiate recovery or enforcement proceedings against a defaulting borrower. However, if the junior lender is restricted from enforcing the common security contractually through an intercreditor agreement, that security package may not be subject to enforcement proceedings.

What rights do junior creditors have during a bankruptcy or insolvency proceeding involving the debtor?

The rights available to creditors for realisation of their loans during bankruptcy or insolvency of the debtor are governed by the Insolvency and Bankruptcy Code, 2016. The Code provides for a detailed procedure in such events.

As per the Code, creditors have the right to determine the mode and manner of distribution of the assets of the debtor. Every financial creditor is granted voting rights to decide on a resolution plan which is in their collective interest. The voting rights granted to the creditor are pro rata to the debt owed to them. However, decisions can be made by majority creditors with higher outstanding and the junior creditors vote may not be taken into consideration.

Pari passu creditors

How do the terms of the intercreditor arrangement change if creditor groups will be secured on a pari passu basis?

The existence of majority lenders' decision exists for an intercreditor agreement where creditor groups are secured on a pari passu basis. However, sometimes each creditor is provided with the individual right to enforce the security for its own outstanding amount. In this instance, a pro rata amount which is due to the enforcing creditor is paid and the remaining amount is deposited with the security trustee to be held in trust for the benefit of the non-enforcing creditors as security.

Loan document terms

Standard forms and documentation

What forms or standardised terms are commonly used to prepare the bank loan documentation?

The Indian Banks Association has circulated standard facility documentation for consortium lending which is followed by most public-sector Indian banks. Usually, lenders follow their own individual formats for bilateral financing transactions; however, the clauses across banks are similar.

Private sector banks usually prefer to follow the documentation as prescribed by the APLMA for syndicated transactions. Most sizeable corporate financing transactions are negotiated and the documentation is modified accordingly.

Pricing and interest rate structures

What are the customary pricing or interest rate structures for bank loans? Do the pricing or interest rate structures change if the bank loan is denominated in a currency other than the domestic currency?

The interest is calculated by reference to a bank rate. The RBI provides the formula which a bank is required to use to calculate its marginal cost of funds-based lending rates. For more information on MCLR, refer to question 14.

Under the external commercial borrowing regulations, the interest rate linked to a foreign loan provided in foreign currency may be linked to six-month LIBOR rate of different currencies or any other six-month inter-bank interest rate applicable to the currency of borrowing (eg, EURIBOR) to determine the all-in cost for the loan. The benchmark rate in case of rupee-denominated external commercial borrowing should be the prevailing yield of the government of India securities of corresponding maturity. The lenders charge a spread over and above the benchmark rates in accordance with the thresholds prescribed.

Borrowing in foreign currency is usually cheaper compared to borrowing in Indian rupees. However, the hedging costs and currency value fluctuations may negate the initial price advantage gained.

Have any procedures been adopted in bank loan documentation in your jurisdiction to replace LIBOR as a benchmark interest rate for loans?

At present the market practice is still unclear and many banks continue to use the LIBOR interest rate where applicable.

Other loan yield determinants

What other bank loan yield determinants are commonly used?

The MCLR of banks act as the pricing floor for lending in Indian rupees. The practice of granting original issue discount is generally not prevalent in India.

Yield protection provisions

Describe any yield protection provisions typically included in the bank loan documentation.

Almost all loan documentations in India include provisions for increased cost, prepayment premiums and withholding tax gross-up provisions.

The increased cost provisions are standard clauses in a loan transaction, wherein an obligation is imposed on the borrower to make good any additional cost incurred by the lender on account of change in the laws and regulations and compliance thereof.

Prepayment premium clauses are also often included as measure for the lender to recover costs in the event that the borrower repays the loan prior to the maturity date. However, there are certain restrictions on the collection of prepayment premium for floating rate loans by banks.

Indian corporates are usually not required to withhold tax while paying interest to banks in India. However, Indian banks do not insist on grossing up payments for tax withholding for other fees charged. Adequate tax certificates are provided to the banks in this regard. Where the loan transaction is between parties in different jurisdictions, tax gross-up provisions are included.

Accordion provisions and side-car financings

Do bank loan agreements typically allow additional debt that is secured on a pari passu basis with the senior secured bank loans?

Loan agreements usually restrict the borrower incurring any additional financial indebtedness without the prior approval of the lender. However, additional loans may be allowed on a pari passu basis with the senior secured lender depending on the purpose of the additional financing and the maintenance of adequate security cover.

Financial maintenance covenants

What types of financial maintenance covenants are commonly included in bank loan documentation, and how are such covenants calculated?

Financial covenants included in bank loan documentation usually provide for maintenance of debt service coverage ratios, maintenance of minimum net worth, maintenance of EBITDA ratios and end-use restrictions on borrowed funds. These covenants are usually stricter in loans that are given to special purpose vehicles, which are very common in project financing transactions. However, the financial covenants are generally more relaxed in general corporate financing in large corporates which have multiple verticals and revenue generating streams.

Other covenants

Describe any other covenants restricting the operation of the debtor's business commonly included in the bank loan documentation.

Some of the other common covenants included in standard loan documentation pertain to:

- negative pledges;
- disposal of assets;
- restrictions on mergers and acquisitions;
- change in business;
- change in constitutional documents;
- payment of dividends; and
- maintenance of credit rating.

Mandatory prepayment

What types of events typically trigger mandatory prepayment requirements? May the debtor reinvest asset sale or casualty event proceeds in its business in lieu of prepaying the bank loans? Describe other common exceptions to the mandatory prepayment requirements.

When a borrower under debt has received an influx of money due to the occurrence of an event, for instance sale of a branch of the business, sale of property owned by the business, the creditor may seek for mandatory prepayment of the loan. The debtor is mandatorily obligated in such an event to direct the proceeds resulting from such events to the payment of loan albeit prior to the maturity date and is not permitted to reinvest the same into its business. Prepayment premiums are usually not imposed upon the occurrence of a mandatory prepayment event.

In some instances, such prepayment may result in adverse tax consequences, in which case the mandatory prepayment may not be enforced.

Debtor's indemnification and expense reimbursement

Describe generally the debtor's indemnification and expense reimbursement obligations, referencing any common exceptions to these obligations.

Where a creditor incurs expenditure or undertakes a liability on behalf of the borrower, the creditor may require the borrower to repay such expenditure or indemnify it for any loss caused. Such terms are generally included in the loan documentation. These may include indemnification for any default and repayment of transaction costs, amendment costs, stamp duty, security agent/trustee fee, cost of litigation, etc. in relation to the loan transaction. The obligation on the debtor is waived only when the loss or cost is incurred by the creditor due to its own gross negligence or wilful misconduct.

Update & trends

Key developments

Are there any other current developments or emerging trends that should be noted?

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India is the fastest growing large economy in the world. Although the lending market has wavered in this regard over the past several years, there seems to have been some hope over the past year for the lending market to do justice to this label. Banks have seen an overall reduction in provisioning against deteriorating assets and an increase in credit growth. The industry seems to be slowly recovering from the overnight de-monetisation of the 500 rupee and 1,000 rupee notes in circulation on 8 November 2016 and the implementation of the Goods and Services Tax. High-profile controversies have affected both public and private sector banks, which have raised eyebrows in regard to the overall conviction of the industry. However, stern measures from regulators and enforcement agencies should help to clear these blemishes on the industry.

There has been an influx of external commercial borrowing transactions, where foreign lenders lend to Indian borrowers, as the external commercial borrowing guidelines have been substantially liberalised and the interest rates of foreign lenders are traditionally lower compared to the Indian market. The past year has also seen significant activity in the financial technology space. This is evidenced by sizeable growth in peer-to-peer lending in the industry, although the RBI has imposed strict limitations on the peer-to-peer lending industry.

The country's inflation rate being lower than expected and stable over the past few years has allowed regulators to periodically reduce interest rates. These are expected to drop further in the coming year, fuelling demand and liquidity in the market.

Masala bonds or rupee-denominated bonds issued overseas have not been a game changer in the bonds space. However, there have been a few sizeable rupee-denominated bond issuances over the past year.

The RBI has introduced new norms for the Resolution of Stressed Assets, which mainly has its focus on recognising stress in assets early on and providing lenders with a strict timeframe to determine a viable resolution strategy in the event of a default. The new framework also removes the mandatory obligation of initiating insolvency proceedings and seeks to promote the formulation of a resolution plan by the creditors for realisation of debt. It imposes a penalty on lenders in the form of additional provisioning for failure to implement the resolution plan.

Kochhar & Co - Anuj Kaila and Swathy Suresh