

Structuring a lending transaction in India

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Structuring a lending transaction

General

Who are the active providers of secured finance in your jurisdiction (eg, international banks, local banks or non-bank financial institutions)?

The Indian market has a plethora of different banks engaged in secured finance. Large corporate financing transactions are mostly funded by the bigger Indian banks, international banks and institutional non-banking finance companies (NBFCs). There are different types of NBFC in India which are sector specific (eg, real estate financing, automobile financing and agriculture finance).

Is well-established market-standard facility documentation used in your jurisdiction for secured lending transactions?

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 Asia Pacific Loan Market Association (APLMA) for syndicated transactions. Most sizeable corporate financing transactions are negotiated and the documentation is modified accordingly.

Syndication

Are syndicated secured loan facilities typical in your jurisdiction?

Yes. Large financing transactions are regularly syndicated. Banks resort to syndication to ensure risk mitigation and to adhere to the Reserve Bank of India's (RBI) large exposure framework.

How are syndicated facilities normally structured? Does the law in your jurisdiction allow a facility agent to be appointed to act on behalf of other banking syndicate members?

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 rights to represent and manage the group of lenders. Usually the lead bank is provided with all rights for enforcement and providing directions to the obligors.

A facility agent is usually appointed for a syndicated lending transaction which adopts the APLMA-style facility documentation. Indian law does not restrict a facility agent to act on behalf of the syndicate members. Indian banks usually 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 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.

Does the law in your jurisdiction allow security and guarantees to be held on trust by a security trustee for the benefit of the banking syndicate?

Yes. The Indian Trust Act 1882 recognises the concept of a trust and a trust is settled in favour of the security trustee who in turn holds the security or guarantee for the benefit of the syndicate members. Appointing a security trustee is very common for syndicate financing transactions. 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) for enforcement of 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.

Special purpose vehicle financing

Is it common in secured finance transactions for special purpose vehicles (SPVs) to be used to hold the assets being financed? Would security generally be given over the shares in the SPV or would lenders require direct asset security?

It is common for SPVs to be created for specific transactions. The SPV acts as the borrower and the assets financed are held with the SPV. It is common for lenders to take the shares and assets of the SPV as security. Lenders also insist on parent companies providing additional security to ensure due compliance with the repayment obligations of the SPV. Creation of SPVs is common in project finance transactions.

Interest

Is interest most commonly calculated by reference to a bank base rate or a market standard variable reference rate (eg, LIBOR, EURIBOR or HIBOR)? If the latter, which is the most commonly used reference rate in your jurisdiction?

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.

Are there any regulatory restrictions on 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.

There are no restrictions to determine interest rates for lending in foreign currency. Banks are free to choose any market-determined external benchmark (eg, LIBOR, EURIBOR or HIBOR) to determine their lending rate in addition to their spread.

Banks are free to determine the default interest rate to be charged on the occurrence of an event of default. However, the RBI mandates banks to formulate a board-approved policy for charging penal interest on advances, which should be fair and transparent.

Use and creation of guarantees

Are guarantees used in your jurisdiction?

Yes. Guarantees are widely used as credit support in many financing transactions. Lenders tend to take corporate guarantees from the parent or holding company of the borrower or personal guarantees from the promoters of the borrower.

What is the procedure for their creation?

A guarantee is usually provided in the form of a deed by the guarantor in favour of the guarantee holders. A guarantee can also be provided in the form of an agreement. A guarantee is deemed created on the execution of the guarantee document. Guarantees are governed by the Indian Contract Act 1872.

Do any laws affect or restrict the granting or enforceability of guarantees in your jurisdiction (eg, upstream guarantees)?

The Companies Act 2013 restricts the issuance of guarantees by companies to guarantee the loan 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% 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.

Subordination and priority

Describe the most common methods of structuring the priority of debts and security.

Priority of debts is usually set by contractual arrangements between the creditors. An inter-creditor 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 of 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.

Documentary taxes and stamp duty

Are any taxes, stamp duty or other fees payable on the granting of a loan, guarantee or security interest, or on its enforcement?

India is a complex jurisdiction with respect to taxes, stamp duty, registration costs and other fees. Stamp duty and other fees are payable to ensure the enforceability of a facility agreement or a security interest. Each state in India stipulates its own stamp duty payable on different types of documents for the document to be enforceable in that state. For example, the stamp duty to be paid on a facility agreement in the state of Karnataka is Rs200. The stamp duty rises to Rs400 if the agreement includes an indemnity clause. Stamp duty for creation of security interest by way of an equitable mortgage, pledge or hypothecation can rise up to Rs10 million per form of security in the state of Karnataka.

Certain states require mandatory registration over a mortgage of a property situated in that state, for which a registration fee is payable. A company is required to pay fees for filing specific forms with the company registry.

As a general rule, a document cannot be admitted as evidence in a court of law if it is stamped insufficiently or if the document is not registered where registration is mandatory. High penalties are prescribed for documents with insufficient stamp duty. The authority is also provided with the right to seize documents that are insufficiently stamped.

Given the numerous intricacies involved in this area, specific advice should be sought before execution of any document in India or which relates to enforceability of the document in India.

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