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A CRITICAL STUDY ON CONSORTIUM LENDING & ITS RECOVERY PROCEDURE UNDER THE INDIAN BANKING SYSTEM

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Abstract

“State Bank of India (SBI) Chairman Rajnish Kumar on Monday said the banking sector should put in order and relook at the consortium lending and multiple banking models as they are increasing the risks and leading to delays in decision banking.”¹ Each respective member of the consortium has discretion for asset classification, getting a no-objection certificate from every member is tedious, which is affected by their balance sheet management. Various lacunas in the monitoring of such accounts as banks end up having congruous loan books when it comes to megaproject loans. Members are bound by the resolution plans (if 66% of members agree) as mooted by the State Bank of India for stressed assets, which are in consonance with intercreditor agreements. The great scope of improvement lies in the prosaic working of banks, which are highlighted by the cases of 38 banks in a single consortium or 17 banks in Kingfisher consortium. This paper highlights the understanding of researchers on the topic of consortium lending, its evolution, various RBI guidelines, the process of consortium lending and the recovery of loan under consortium arrangements. We have also tried to critically analyze these topics and provide technology-based suggestions and recommendations to improve integrated and joint monitoring capabilities of daily transactions for keeping trail of diversion, round tripping, drawing power, system identification of non-performance of assets and defaults to enable transparent, expeditious decision making and implementation.

¹ENS Economic Bureau, *Consortium lending: SBI chief Rajnish Kumar says banks should review models*, August 21, 2018, available at <https://indianexpress.com/article/business/banking-and-finance/consortium-lending--sbi->

1. Introduction

1.1 Development of Consortium Finance

The banking sector plays a pivotal role in the operation and expansion of any country's economy since the time of civilization of Babylon. Banks play a prominent role in planning and implementing financial policy. The history of consortium lending runs down where a large loan amount was granted to a single borrower by two or more banks under a common application, the security was given against a joint deed of pledge or hypothecation. The evolution of consortium finance regulation has sought to ensure a smooth flow of credit to lenders with the prudential structure required for credit risk management. Apart from interest rates, all consortium contracts have common terms and conditions. Many large borrowers prefer to have various banking relationships, under which they have an independent arrangement with each lender, the security offered to each institution is completely distinct, and there is no structured understanding between different lenders financing the same borrower. In such consortium arrangements, loans are generally approved on distinct terms and conditions by different lenders. The borrower gets to prospect one bank against others to crack the best deal. Consortium lending helps in dispersing the risk for banks as multiple lenders and involved in financing a larger borrower. This forbids the lender from taking irrational choices.

Consortium finance lending is an association of banking companies, financial institutions or individuals. The objective behind forming the consortium is to pool their respective resources for common investment. Lately, the participating members contribute according to the strength of their purse which creates majority and minority shareholders. This scenario is juxtaposed to the earlier concept of consortium lending wherein the lenders were working as a subsidiary owned by various banks situated in various countries.

1.2 RBI facilitating the development of Consortium Finance

Under the chairmanship of G.Lakshminaryanan, Reserve Bank of India commissioned a study group in the year 1973, December this was the first attempt in this regard. The report received its assent in the year 1974, July. Later to this Mahadevan Committee and J V Shetty Committee

were instituted for achieving a single-window concept for lending and minimizing aggravation as well as lag to borrowers. Presently the consortium lending is being regulated by Master Circulars on Loan

Although the modalities of the functioning of a consortium including allocation of limits, interest rates, sanction of ad hoc limits, sharing patterns are left with banks to decide in the consortium meeting. Consortium financing encompasses taking a salubrious view of the entire operations of larger borrowers to assess credit requirements (working capital and/or term loans) with affordability in operations on the basis of joint security and agreement on the exchange of critical information between banks and lenders. Members have the freedom to independently classify their share of assets on the basis of the recovery record.

1.3 Streamlining and Harmonizing the lending processes

Indian Bank Associations (IBA) have recommended a colloquial template for documentation to bring in the homogeneity which includes:

- working capital consortium agreement
- revival letter for purposes of limitation
- agreement to be signed with the lead bank who signs on behalf of itself and on behalf of other member banks.
- resolutions to be passed by the borrower's Board of Directors authorizing the borrowing company to borrow under the consortium arrangement
- joint deed of hypothecation
- letter of undertaking from the borrower for creating a second mortgage on the fixed assets

By the virtue of stiff competition, the different banks end up providing various banking facilities and funds to a single borrower against the same securities without having a consensual arrangement between the lenders which expose the banks to great risk of non-performing assets and frauds as seen in the Kingfisher case and Nirav Modi PNB case.

Voluminous borrowers may sometimes prefer to have multiple banking relationships with substantial operational pliability, benefiting from an independent arrangement with different banks and separate security interests, without any formal common understanding for the exchange of any critical information. However, multiple banking is emulous to the spirit of regulatory intentions that appear to be relatively better served by consortia as a result of dodging the overexposure to a single borrower and risk-spreading compared to silos.

2. Current Regulatory Framework of Consortium

At present, the consortium finance is in alignment with the following regulatory framework of RBI:

- The compliance which the lenders need to abide by while exposing themselves to a single borrower up to the threshold limit of 15 % of the capital funds (20% for Infrastructure Projects) and 40% to the group borrower (50% for Infrastructure Projects). As per the capital adequacy standard, the capital funds for the same are categorized in Tier I and Tier II. the kind of exposure as follows:
 - Investment Exposure (Underwriting and Similar Commitments)
 - Credit Exposures (Funded and Non-Funded Credit Limits)
 - Certain types of Investments in Companies

The exposure limits are derived while considering sanctioned or outstanding limits whichever is higher but not including loans and advances granted against the security of the bank's own term deposits. For the purpose of Letter of Credit, if they are issued from the same bank the exposure is on the borrower but if the discounting/purchasing/negotiating is done from a different bank then the exposure is on the LC issuing bank.

- Classification of the share of loan limits can be done by members of the consortium as per their record of recovery and other aspects having a bearing on the advance recoverable. When the pooling of resources is done as per the arrangements of a consortium with one bank (Leader) or remittances by the borrower and/or where it is not

parting with the share of other member banks, the account will be treated as not serviced and be treated as NPA (substandard/doubtful or loss asset) by such member banks of the consortium and make provisions accordingly in their books. As they deem fit, the participating bank can demand their share of the recovery from the Leader or get express consent to transfer their share of the recovery to warrant proper classification of assets in their books respectively. These measures are in accordance with the guidelines of the Reserve Bank of India which are in effect from 1st April 2015 a standard account on restructuring (for reasons other than the change in date of commencement and commercial operation) would be immediately classified as substandard on restructuring as also the non-performing assets, upon restructuring, would continue to have the same asset classification as prior to restructuring and slip into further lower asset classification categories as per the extant asset classification norms with reference to the pre-restructuring repayment schedule. The banks need to customarily abide by the principle-based approach rather than the rule-based approach. The classification should be on the basis of objective criteria and with uniform & consistent application of the norms.

- As per disquietude expressed by Central Vigilance Commission with respect to frauds and data breaches in the working of the consortium lending arrangements. Banks are expected to fortify their critical information relating to the borrowers of the consortium arrangements by using state of the art technology such as Blockchain, Artificial Intelligence. All such instructions issued from time to time by RBI have been collated under the Master Circular as detailed below:
 - Banks are advised to strictly adhere to the instructions regarding the sharing of information relating to credit, derivatives and unhedged foreign currency exposures among themselves and put in place an effective mechanism for information sharing. Non-adherence to the above instructions by banks is viewed seriously by the Reserve Bank and the defaulting banks would be liable to an action, including the imposition of penalty, wherever considered appropriate.
 - At the time of granting fresh facilities, banks may obtain declarations from the borrowers about the credit facilities already enjoyed by them from other banks in the format prescribed.

- Exchange information about the conduct of borrowers' accounts with other banks in the specified format at least at quarterly intervals.
- Obtain regular certification by a professional, preferably a Company Secretary, Chartered Accountant or Cost Accountant, regarding the compliance of various statutory prescriptions that are in vogue.
- Make greater use of credit reports available from a Credit Information Company, which has obtained Certificate or Registration from RBI and of which the bank is a member.
- Incorporate suitable clauses in the loan agreements in the future (at the time of next renewal in the case of existing facilities) regarding the exchange of credit information so as to address confidentiality issues.²

Strict adherence regarding the sharing of information relating to derivatives, unhedged foreign currency exposures, and credit must be practiced, to mitigate exposure among consortium members. The consortium must put in a robust and effective information sharing mechanism as per the prescribed format at least available quarterly. It is the statutory mandate for lenders to attain declaration from the borrowers about credit facilities from other banks, credit reports from credit information bureaus, incorporate suitable clauses in the loan agreements for the exchange of credit information to address confidentiality issues, certification for compliance to statutory prescriptions. Non-compliance with the above-mentioned instructions by banks will attract serious implications from Reserve Bank of India such as imposing a penalty, wherever appropriate

3. Recovery Procedure

3.1 Procedure under SARFAESI and other Acts

Indian Legal system encompasses varied legal provisions for recovery of debts by the Banks and Financial Institutions as follows: -

- Summary suits under Order XXXVII of the Code of Civil Procedure, 1908.

² *Master Circular- Loans and Advances – Statutory and Other Restrictions*, RBI/2015-16/95 BR.No. Dir.BC .10/13.03.00/2015-16, July 1 2015, available at https://m.rbi.org.in/Scripts/BS_ViewMasCirculardetails.aspx?id=9902 Last Seen on 8th March 2020

- Ordinary suits for recovery, under Civil Law.
- Original Applications to be filed by Banks and Financial Institutions before Debt Recovery Tribunal for debt not less than Rs. 10 lakhs, under Recovery of Bank Due to Banks & Financial Institutions Act, 1993 (DRT Act).
- Action under Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (Securitization Act).
- Arbitration proceedings under Arbitration & Conciliation Act 1996, for recovery of outstanding amounts as under Arbitration Agreement / clause in the loan documents, in cases where the Recovery of Debts due to Banks and Financial Institutions Act, 1993 is not applicable.
- Initiation of criminal action in addition to civil proceedings for prosecution and punishment as per the Indian Penal Code and other laws where debt is also tainted with fraud, cheating, misfeasance etc.
- Filing of criminal complaint under Section 138 of Negotiable Instruments Act, 1881 for dishonor of any cheque issued by borrower to the bank in discharge of legally enforceable liability

Broad Classification of the Debt Work Out Process in India

Amount to be recovered	Procedure
Does not exceed Rs. 10,00,000/-	<ol style="list-style-type: none"> 1. Filing a simple suit for recovery before Civil Court. 2. Filing of summary suit under Order XXXVII of CPC, 1908. 3. Filing suit for foreclosure of mortgage. 4. Arbitration proceedings if arbitration agreement exists.

Exceeds Rs. 1,00,000/-	In case the "Security Interest" has been created in specific movable / immovable property provisions of the Securitization Act may be invoked to repossess the mortgaged property, without intervention of the court, and sell the same, provided the account has been classified as NPA.
Exceeds Rs. 10,00,000/-	Original application is to be filed before the DRT for recovery of dues. Banks can simultaneously initiate proceedings under the Securitization Act as well. Civil court / Arbitrator will not have jurisdiction to entertain such a claim.

Debt Recovery Tribunals & Process of Recovery

Debts Recovery Tribunals (DRT) and Debts Recovery Appellate Tribunals (DRAT) have been constituted under the provisions of the DRT Act for establishment of Tribunals for expeditious adjudication and recovery of debts due to Banks and Financial Institutions and for matters connected therewith has also been given the power to adjudicate the applications filed by the Borrower/Mortgagor against the action of the Secured Creditor initiated under the Securitization Act.³

Withdrawal of suit pending before DRT under DRT Act, 1993 is not a precondition for taking recourse to the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 is an additional remedy, which is not inconsistent with DRT Act, 1993 and, therefore, doctrine of election has no application.⁴

³SNG & Partners, *India: Recovery Process & Enforcement of Security Interest in India*, September 5 2017 available at <https://www.mondaq.com/india/Finance-and-Banking/626056/Recovery-Process-Enforcement-Of-Security-Interest-In-India>

-Interest-In-India Last Seen on 21st March 2020

⁴Transcore Vs Union of India, AIR 2007 SC 712, MANU/SC/5319/2006

3.2 Procedure for Financial Creditors Under Insolvency and Bankruptcy Code 2016

“Financial Creditor” and “Financial Debt” is defined under section 5(7) and 5(8) of the IBC respectively.

Procedure of CIRP

The Process for Initiating the Corporate Insolvency Resolution Process (CIRP) by a Financial Creditor has been defined under Section 7 of the IBC.

Stages of CIRP

- a. Publication of Notice - Notice will be published by Resolution Professional to call for filing claims against the corporate debtor by a stipulated deadline.
- b. Processing of Claim – All claims will be verified from the books of accounts of the debtor.
- c. Information Memorandum – After claim verification, a memorandum of all liabilities and assets of the corporate debtor will be made. This memorandum will be sent to all the Financial Creditors, whose claims have been accepted.
- d. Meetings of Committee of Creditors – Once memorandum is sent, a meeting of COC will be held which includes the financial creditors of the Corporate Debtor, to decide the correctness of the memorandum.
- e. Calling for a Resolution Plan – The RP after formation of an information memorandum will call/invite, by an advertisement in the newspaper, for the resolution plans for the Corporate Debtor by the Resolution Applicants.
- f. Acceptance or Rejection of Resolution Plan – A meeting of COC will be conveyed to check the resolution plan resulting in its acceptance or rejection. The resolution will be adopted by 2/3rd majority votes, after this is submitted before NCLT for final consent.
- g. Extension if any – The time duration for the completion of the CIRP is 180 days, however, If the Resolution Plan is not accepted by the COC within 180 days then they can extend the time duration for a period of not less than 90 days.

h. Liquidation – In case where a resolution plan is neither to the satisfaction of COC nor even voted with majority voting of 66% in favor of a resolution plan coupled with the fact of lapse of CIRP period to a maximum period of 270 days then COC will opt for liquidation of such a Corporate debtor.

Case Snippet: Jet Airways became the first Indian company to undergo cross border insolvency proceedings. “Consortium led by SBI have decided to seek resolution under IBC since only a conditional bid was received and requirement of the Investor for SEBI exemptions and resolution of all creditors is possible under IBC. Lenders led by State Bank of India have been making efforts to find a resolution for Jet Airways outside IBC but in view of the above, lenders have decided to seek a resolution within the IBC process”.⁵ At present Jet Airways gets 90 days more for resolution under IBC from NCLT due CoronaVirus Pandemic.

4. Critical Observations on Consortiums

The very advantage of consortium finance is risk spread and prevention of overexposure to banks from single borrowers in scenarios of big projects, if these lending go sour, the Income statement of even healthy and stronger bank(s) can be severely affected. Consultative decision-making processes minimize the risk of rash decisions. However, perspicacious observations has raised various concerns and issues like ineffective monitoring, lack of timely exchange of vital information, paucity of communication, detrimental treatment to members, arm twisting by bigger lenders, differential asset classification (NPAs) with a view of balance sheet management, round tripping, management information system (MIS) issues, issues in recovery and resolution, leveraging the gaps in group monitoring by borrowers etc. minority members are dragged along with member banks having majority share in absence of any incentive or information to independently assess consortium proposal. Though consortia are apprehended to refine structures for sizeable financing in contrast to multiple banking, backed by operational instruction by

⁵Saloni Shukla, Joel Rebello ET Bureau, *SBI-led consortium to take Jet Airways to NCLT seek resolution under IBC*, June 18, 2019, available at <https://economictimes.indiatimes.com/industry/transportation/airlines/-aviation/sbi-led->

[-consortium-to-take-jet-airways-to-nclt-seek-resolution-under-ibc-reports/articleshow/69825957.cms](https://economictimes.indiatimes.com/industry/transportation/airlines/-aviation/sbi-led-consortium-to-take-jet-airways-to-nclt-seek-resolution-under-ibc-reports/articleshow/69825957.cms) Last Seen on 25th March 2020

regulators, a contrary picture is surfacing as highlighted by SBI chairman in a press conference (Et Dt August 21, 2018)⁶. He had expressed the need to revamp the consortium lending model as the Indian banking system is dominated by state run banks with nearly three fourths of the market share weighed down by bad loans.⁷ Flustered by alarming rise in frauds involving consortium arrangement, Central Vigilance Commission, Government of India has raised the red flag with regards to functioning consortium lending. These frauds are proportionally related to lack of robust sharing of information mechanisms for credit history and performance of consortium borrowers accounts among member banks.

5. Conclusion and Recommendations

In order to document and track the transactions in a consortium arrangement we need an automated recording platform which would ensure better transparency and enable preventive measures to control risks relating to consortiums and enhance the management of risks. There needs to be a robust automated consortium portal involving Artificial Intelligence and Blockchain technology for real time data transfer and data sharing which would strengthen the member's capabilities to assess and review the borrower's financial credibility, history, trail and behavior. It would allow system identification of NPAs on the basis of predefined triggers and would provide efficiency for various NPA related activities such as asset restructuring, provisioning, recovery, timely classification of non-cooperative borrowers as deliberate defaulters, selling to Asset Reconstruction Companies (ARCs), write-offs, prompt invocation and creation of joint lenders (JLFs), adoption of appropriate NPAs. The recommendations derived from the survey that help to develop the proposed technology solution for the management of consortiums. Specific benefits emerging from these can be automated reporting systems with transaction monitoring engines that may provide for preventive controls and accountability by providing controls for integrated credit management, smart system recognition of NPAs improve the overall management of consortia or multiple banking credit risk. Such a

⁶Supra at Note 1

⁷Ibid

seamless approach will improve the actions and efficiency of lenders and borrowers alike. A popular platform for hosting all consortia in the banking system allowed by automated engines with day-to-day updates of transaction data owned by the regulator appears to be a promising solution. This will be able to plug cracks and develop efficiencies to revitalize the sector and have greater leverage in the hands of banker financing companies.