Banking Consortium And It's Legal Aspects

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What is Banking Consortium and What are its Various Aspects?

The lending of advances has always been one of the primary functions of the bank. However, it also involves risk because the bank as a lender has to suffer if the borrower defaults in payment of the loan. The risk will be comparatively lesser when the amount of money is less but when the amount of money is huge, the risk will be higher and it is during such circumstances the bank indulge in the practice of banking consortium.

What Is Banking Consortium?

Banking consortium refers to the practice where several banks join together and lend money to a single borrower. It consists of three parties namely lead banks, member banks and the borrower. Lead banks refers to those banks which initiate or undertake the banking consortium while member banks are those banks which agree to contribute their share in the amount of loan which is to be sanctioned to the borrower. Under this arrangement, the lead bank will enter into a common agreement with other member banks to provide financial assistance to the borrower if the amount of money demanded by the borrower is so huge that it is not possible for a single lender to provide financial assistance to the borrower

Purpose Of Banking Consortium

Banking consortium is undertaken by the bank in the following instances:

- Risk-sharing – It is a known fact that lending of finances involves an element of risk; higher the amount, higher the risk. So the banks in such cases decide to enter into a consortium agreement with other banks.
- Maintain the exposure limit- As per the regulations of RBI, the banks have a limit on credit exposure and the banks cannot provide financial assistance to the borrower beyond such limits. So the banks resort to the practice of entering into a consortium agreement with other banks.

Procedure Involved In Banking Consortium

Under this type of arrangement, a prospective borrower approaches one particular bank for availing financial assistance. The bank will then evaluate the proposal and decide on the members along with whom they will enter into the banking agreement. The member banks will evaluate the proposal and decide on their share in the amount which will be lent for the purpose of the financial assistance to the borrower.

The banks under consortium are bound by the following procedures:

- Evaluation of proposal
  The lead bank after evaluating the proposal will send the proposal to other banks for the purpose of evaluation. The other banks will convey their acceptance based on the feasibility of the proposal.
- Documentation
  The banks will examine the authenticity of the documents which are provided by the borrower for the purpose of availing financial assistance.
- Credit Information Exchange
  After examination of documents, the banks will ask the borrower to furnish credit information report either from the bank which he is already a customer of or from the bank which has previously provided financial assistance to the borrower.
- Consortium agreement
  After being satisfied with the credit information report of the borrower, the lead bank and member banks enter into a consortium agreement with the borrower.

Difference Between Loan Syndication, Multiple Banking Arrangement And Consortium

The meaning of loan syndication, multiple banking arrangement and consortium is confusing and in some cases, they are used interchangeably, so it is vital to understand the difference between them:

- Banking Consortium- It is an arrangement where the lenders agree to share the amount of money that will be lent to the single borrower.
- Loan Syndication- It is also similar to banking consortium but it is used in reference to loans involving international transactions, different currencies, and necessary banking co-operation to guarantee payments and reduce exposure.
- Multiple banking arrangements- Under this arrangement, the borrower simultaneously borrows money from other banks but those banks are not related to each other like in case of banking consortium.

Laws In India Relating To Banking Consortium

Generally, there is no statutory enactment specifically relating to banking consortium, however, they are governed by regulatory norms of RBI. The banks in general resort to banking consortium based on the credit limit exposure by RBI which says that the exposure limit in general for banks is 15 percent of capital funds for the single borrower and 40 percentages of capital funds for a group of borrowers. However, the limit on exposure will be 50 percent for group borrowers and 20 percent for a single borrower if the fund provided are to be utilized by the borrower for the purpose of infrastructure projects[1]. Further, RBI has laid down certain rules for banks who have entered into consortium agreement[2]:

- Banks should obtain information from the borrowers regarding the facilities enjoyed by the borrowers.
- Banks should also ask for information about the borrowers from other banks.
- Banks should also obtain certification from the Chartered Accountants, Company Secretary or Cost Accountant regarding the compliance of statutory norms by the borrowers.

Section 13 of Securitisation and Asset Reconstruction Act 2002 provides for the banks to enforce security interest on the assets of the borrower. As per this, if the borrower defaults in payment of loan amount then the notice should be issued to the borrower if his account coverts into a non-performing asset. The notice should specify the amount payable by the borrower and also that if the borrower fails to pay the amount then legal action will be taken against him. The borrower will be required to make a representation regarding the notice.

If he gives a reply to the notice of the lender then he should communicate whether he is satisfied with the representation of the borrower within 15 days of receipt of the notice. However, if the borrower fails to reply to the notice then lenders will have the option to take possession of assets of the borrower or take over the management of the business.

Conclusion

Banking consortium indeed enables the banks to reduce risks on the advances which are lent by them and also helps them to credit limit exposure as specified by the RBI. However, we also cannot deny the fact that this banking consortium will also prove to be costly for the banks if they have not secured the assets of the borrower. We also know that in the classic case of *Vijay Mallya vs State Bank of India and others*,[3] the banks under consortium did not secure the assets of the borrower. The case is still on hold and no proper remedies were availed by the banks against the borrower.

From the above, we can infer that legal protection is available for banks under the consortium arrangement provided they have secured the assets of the borrower. Therefore, we can conclude by saying that there is a need for legislation that provide remedy to the lenders if they have not secured any assets of the borrower.

- [1] https://www.rbi.org.in/Scripts/BS_CircularIndexDisplay.aspx?Id=3118
- [2] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=4487&Mode=0
- [3] W.P. no.16351 of 2018

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