

REPORT
OF
THE COMMITTEE
TO REVIEW
THE SYSTEM OF LENDING
UNDER CONSORTIUM ARRANGEMENT
RESERVE BANK OF INDIA

AUGUST 1993



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| | Pages |
|---------------------------------------|-------------------|
| Letter forwarding the Report | 1 - 11 |
| Summary of the Recommendations | 111 - viii |

REPORT

| | | |
|--------------|---|---------|
| Chapter I | INTRODUCTION | 1 - 6 |
| Chapter II | BACKGROUND | 7 - 15 |
| Chapter III | DIFFERENT ALTERNATIVES/VIEWS TO THE EXISTING SYSTEM | 16 - 18 |
| Chapter IV | MERITS AND DEMERITS OF SUGGESTED ALTERNATIVES | 19 - 26 |
| Chapter V | OBSERVATIONS | 27 - 30 |
| Chapter VI | LENDING NORMS AND GUIDELINES | 31 - 34 |
| Chapter VII | SINGLE WINDOW CONCEPT OF LENDING BY BANKS - DOCUMENTATION | 35 - 38 |
| Chapter VIII | RECOMMENDATIONS OF THE COMMITTEE | 39 - 53 |
| Chapter IX | CONCLUSIONS | 54 - 55 |
| Appendix I | Reserve Bank of India Memorandum constituting the Committee | 56 - 58 |
| Appendix II | Names of banks/institutions/ organisations/persons, who submitted oral/written comments/ suggestions/views to the Committee | 59 - 61 |
| Appendix III | Consolidated statement of comments/ suggestions/views of banks in reply to the questionnaire forwarded to them | 62 - 71 |
| Appendix IV | Lending under consortium arrangement - a brief resume | 72 - 75 |

जे. वी. शेट्टी

अध्यक्ष व प्रबंध निदेशक

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DO JVS 338

August 19, 1993

Dear Dr. Rangarajan,

I have pleasure in submitting the Report of the Committee constituted for the purpose of reviewing the system of lending under Consortium Arrangement by Banks.

The Committee appreciates the contribution made by a large number of representative organisations and individuals, who submitted their comments/suggestions/views orally and/or in writing on the subject of the Committee's work in response to its request.

The other members of the Committee and I would like to place on record our appreciation of the contribution to the work of the Committee made by our Member-Secretary, Shri P.K. Biswas, who not only took part in the deliberations of the Committee, but also eased the burden of the work with his deep knowledge and understanding of the Issues pertaining to the lending discipline, guidelines and the need for liberalisation of controls for growth and development.

The Committee also places on record its sincere appreciation of the services rendered by Shri K.K. Chaudhuri, Joint Chief Officer and Smt. Chitra, Deputy Chief Officer for their active involvement at every stage of the proceedings.

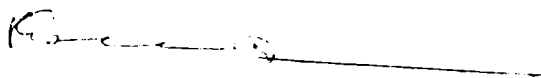
The Reserve Bank of India provided excellent logistic support and the Committee would like to convey its special appreciation for this to the Bank.

- (11) -

Smt. A.D. Kale of the Reserve Bank of India bore the brunt of the stenographic and typing work and her services deserve special mention.

With kind regards,

Yours sincerely,



(J.V. SHETTY)
CHAIRMAN & MANAGING DIRECTOR

TO

Dr. C. RANGARAJAN,
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Summary of Recommendations

The Committee recognises the need to shift to market-driven banking from the present practices. Approach of the Committee has, therefore, been to ensure smooth transformation of the banking system during the current period of transition. The objectives behind the recommendations have, therefore, been to ensure financial discipline on the part of the borrowers together with improvement in the services offered by the banking system in the interregnum till the system completely switches over to market-driven banking. The Committee, therefore, recommends introduction of syndication together with continuation of the existing consortium arrangement, in the case of consortium arrangement with substantial modifications to ensure that it becomes simpler and more flexible to meet quickly the credit needs of the trade and industry.

2. In order to usher in market-driven banking the Committee recommends enhancement of the present threshold limit of Rs.5 crore to Rs.20 crore with immediate effect and to Rs.25 crore or above by March 31, 1996, for mandatory formation of a consortium when a borrower enjoys fund-based credit limits from more than one bank. The Committee also recommends that in the light of the experience gained the desirability of dispensing with the concept of threshold limit itself may be considered in due course.

3. The Committee recommends introduction of syndication for borrowers enjoying fund-based working capital limits of Rs.25 crore or above from the banking system.

4. With the objective of ensuring financial discipline the Committee recommends that borrowers availing of credit facilities under multiple banking should submit details of

credit facilities already availed of from different banks duly certified by their auditors, each time a fresh facility/enhancement is sought for.

5. Considering the basic objective for forming consortium/syndication, i.e., dispersal of risks, the Committee recommends that banks can voluntarily form consortium even in cases where total limits are below the proposed enhanced threshold limit.

6. The need for expeditious disposal of credit proposals to meet the working capital requirements is well recognised and the following maximum time-frame has been prescribed for this purpose.

| | <u>Maximum time frame for disposal of over-all credit proposals</u> | <u>Maximum time frame for disposal of export credit requirement</u> |
|--|---|---|
| Proposals for sanction of fresh/enhanced credit limits | 60 days | 45 days |
| Proposals for renewal of existing credit limits | 45 days | 30 days |
| Proposals for sanction of ad-hoc credit limits | 30 days | 15 days |

7. One of the main reasons for delay in arriving at decisions has been non-submission of required data and information, particularly, the audited accounts. The Committee, therefore, recommends that banks may review borrowal accounts during the first quarter of the current

year (April to June) based on the audited statements for the year before last, provisional statements for the last year, current year estimates and projections for the next year and consider releasing 50 per cent of the additional requirement of credit subject to submission of audited accounts at a later date for release of the balance amount.

8. To expedite the process of disposal of proposals, banks should delegate sufficient power to their functionaries attending consortium meetings.

9. As a meaningful participation in a consortium should be determined based on the extent of share of a member in the credit limits rather than by limiting the total number of member-banks in a consortium, the present ceiling of number of banks in a consortium should be dispensed with and banks should instead take a minimum share of 5 per cent of the fund-based working capital limits or Rs.1 crore, whichever is more.

10. The set of documents under single window concept of lending for meeting the requirements of a borrower in a consortium has been revised and the same has been approved by the Managing Committee of Indian Banks' Association. The Committee recommends that the Reserve Bank of India may please adopt the revised set of documents and consider issuing of suitable instructions to this effect to the banks.

11. In order to ensure credit requirements of borrowers are met fully and within the maximum time-frame prescribed,

borrowers will be free to induct new banks into a consortium. However, the entry of a new bank will be subject to its fulfilling certain procedural requirements to ensure financial discipline.

12. Banks will also have freedom to leave a consortium after a minimum period of two years subject to certain conditions. Further, it will be left to an individual bank in a consortium to decide about acceptance of its enhanced share for meeting additional credit requirements of a borrower.

13. The present discipline of banks being not permitted to extend any type of credit facility to borrowers, where they are not members of the consortia, or where such borrowers are not their regular constituents, will continue.

14. The terms and conditions governing the sanction of credit in a consortium should be uniformly applied by all members and are equally applicable to the rate of interest for different categories of advances.

15. At present pricing of loans and advances by individual member-banks in a consortium is not possible. With advent of market-driven banking and hence market-determined interest rates, it should be possible for banks to adopt independent pricing in due course. A beginning in this regard can be made now by adopting 'pricing' for facilities to be extended under syndication.

16. The lead bank should be vested with the responsibility of arranging for sanction and disbursement of credit (including documentation) as also for monitoring the account in the matter

of advising operative limits, verification of security, etc. The view of the lead bank and the bank having the next largest share will prevail in cases of disputes arising among members relating to terms and conditions of sanction.

17. The lead bank should have the freedom to sanction additional credit by a pre-determined percentage to meet emergent situations/contingencies.

18. The lead bank should be entitled to a fee, say 0.25 per cent of the limits per annum, to be borne by the borrower, for services rendered.

19. For assessment of credit requirements, borrowers having multi-division/multi-product companies should be treated as one single unit, unless there is more than one published/audited balance sheet and should be financed by one consortium. Similarly in the case of mergers one consortium should finance the merged unit.

20. The lending norms for arriving at the maximum permissible bank finance should henceforth be regarded as guidelines. Banks must have discretion to apply these norms with more flexibility.

21. Commercial paper should be made more popular by increasing its tenure to 360 days and developing an active secondary market for the instrument. CP should continue to be carved out of maximum permissible bank finance, as hitherto, as standby facilities/restoration of credit limits provide better investor confidence.

22. The legal framework permitting public limited and public sector companies to issue debentures for augmenting their long-term sources for working capital requirements to the extent of only 20 per cent of their gross current assets, loans and advances should be reviewed to consider raising this ceiling.

23. Inter-bank participation certificates could be made a more effective and popular money market instrument by making it freely transferable 'with risk' and/or 'without risk' as also permitting its issue on usance beyond 90 days. Further, an active secondary market for the instrument could be created by allowing money market mutual funds to invest in them.

Chapter I

Introduction

I.1 Trade and industry had been voicing their concern for some time over the difficulties being faced by them in complying with the existing guidelines on lending discipline prescribed by the Reserve Bank of India (RBI) for assessing the quantum of working capital to be provided to borrowers by the banking system. Consequent to the issuance of instructions on July 27, 1992, by Reserve Bank of India, reiterating the extant guidelines on discounting/rediscounting of bills, as also on lending under consortium arrangement, several representations were made by the Chambers/Confederations/Associations of trade and industry on the hardship faced by them (Under the extant guidelines on lending under consortium arrangement banks are prohibited to sanction facilities to borrowers, who are financed by other banks/consortia of banks without the consent of the financing bank/consortia). The issues raised in different fora are as under :

- (a) Implementation of RBI guidelines would affect discounting of genuine trade bills;
- (b) Restrictions imposed on banks for not extending credit to borrowers, where banks are neither regular bankers nor members of consortia, might result in non-availability of adequate bank credit in time;
- (c) Lending discipline evolved on the basis of the recommendations of the Tandon/Chore Committee, though modified from time to time, have become outdated; and
- (d) The guidelines for lending under consortium arrangement could be more flexible.

I.2 In response to a series of discussions held with the representatives of trade and industry as also certain lending banks, a meeting was convened by the then Governor, Reserve Bank of India, on November 4, 1992, with high level participation from the major banks, all-India Chambers/Confederations/Associations and officials from the Government of India to elicit their views and devise ways to sort out the problems faced by the industry. It was commonly/universally agreed in the said meeting that while financial discipline was necessary, the present set of guidelines on lending discipline and norms also needed to be reviewed. It was, therefore, decided that while the aberrations noticed in the system of lending by banks needed to be reconciled immediately to ensure that the working capital facilities extended to borrowers conformed to the prescribed discipline and norms, a Committee should be constituted to review the existing policy, concept, etc., and suggest changes that might be warranted in regard to lending under consortium arrangement.

I.3 It was in this context that the Reserve Bank of India appointed the Committee on January 5, 1993, to review the extant guidelines on lending under consortium arrangement and suggest measures for improving the existing arrangement and/or any alternative system with the objective of further improving efficiency of the banking system in delivering credit. A copy of the Memorandum constituting the Committee is enclosed as Appendix I.

I.4 The members of the Committee are :

- | | | |
|----|---|------------------|
| 1. | Shri J.V.Shetty Chairman and Managing Director Canara Bank Bangalore | Chairman |
| 2. | Shri D.Basu [@] Deputy Managing Director State Bank of India Bombay | Member |
| 3. | Mr.G.C.Dobby Chief Executive Officer The Hongkong and Shanghai Banking Corporation Bombay | -do- |
| 4. | Mr.Jean Claude Tremosa Chief Executive Officer Banque Nationale De Paris Bombay | -do- |
| 5. | Shri Harbhajan Singh Executive Director Punjab National Bank New Delhi | -do- |
| 6. | Shri A.T.Pannirselvam [£] Executive Director Bank of India Bombay | -do- |
| 7. | Shri Supriya Gupta [*] Deputy Managing Director State Bank of India Bombay | -do- |
| 8. | Shri P.K.Biswas Joint Chief Officer Reserve Bank of India Industrial & Export Credit Department Central Office Bombay | Member-Secretary |

[@] Since appointed Chairman, State Bank of India, and his place in the Committee has been filled in by Shri Supriya Gupta, Deputy Managing Director, State Bank of India

[£] Since appointed Chairman and Managing Director, Union Bank of India

^{*} Co-opted as additional member in April, 1993

I.5 The Committee first met on February 2, 1993, to discuss the methodology to be adopted and to gather information for the purpose. The meeting was addressed by Shri D.R.Mehta, Deputy Governor, Reserve Bank of India, and Ms.I.T.Vaz, Executive Director, Reserve Bank of India. Both Shri Mehta and Ms.Vaz impressed upon the Committee on the need to address itself to the problem of inadequate credit made worse by delay in sanction. Shri Mehta observed that in keeping with the structural changes taking place in the Indian economy, it was but essential that the banking system also should fall in line to meet the twin objectives of meeting in time the credit needs of the trade and industry on one hand, and yet ensure that banking business was conducted on profitable lines.

I.6 In its very first meeting the Committee recognised that while the banking system has to gear up to meet the credit demand of trade and industry in the context of liberalisation of economic controls, there would inevitably be a need for sharing of risk and resources among the banks where lending to large borrowers was concerned. The Committee deliberated on the extant guidelines prescribed by Reserve Bank of India on lending discipline as also on lending under consortium arrangement, with particular reference to the problems voiced/hardships faced by trade and industry. Discussions also veered around the systems and practices prevalent in other countries in the delivery of working capital finance and sharing of risk. It was felt that the alternatives before the Committee were either to evolve a new system and/or to modify the existing

system retaining its intrinsic advantages and yet leaving scope to incorporate what is of relevance in the systems practised in other countries. The Committee decided to discuss the issues with a representative cross-section of bankers, Associations of trade/industry and experts in the field before formulating its views on the terms of reference.

I.7 In accordance with the decisions taken at the first two meetings, a structured questionnaire was forwarded to banks seeking their views on the various aspects of lending under consortium arrangement. Further, the Committee heard the views of the representatives of trade and industry, banks and experts in separate meetings held with them. The names of organisations/individuals, who submitted their views and those who tendered oral submission before the Committee, are furnished in Appendix II. The questionnaire circulated to banks and their responses to it are tabulated in Appendix III.

I.8 The Committee is grateful to all those persons and organisations listed in Appendix II for offering valuable suggestions as also for sparing their time for discussion on various issues arising out of its terms of reference, written responses, etc. The Committee wishes to express its sincere thanks to Shri D.R.Mehta, Deputy Governor, and Ms.I.T.Vaz, Executive Director, for outlining the purpose, scope, etc., of its work in its first meeting. The Committee was ably assisted by Shri K.K.Chaudhuri,

Joint Chief Officer, and Smt.Chitra Chandramouliswaran, Deputy Chief Officer, of the RBI and Shri Niamatullah, Deputy General Manager, of State Bank of India, and would like to record its deep appreciation of their contributions. The Committee is indebted to the staff of the Policy and Monitoring Division of the Industrial and Export Credit Department of Reserve Bank of India, particularly, Shri P.P.Gonsalves and Shri P.G.Bagul, Assistant Industrial Credit Officers, and Smt.A.D.Kale, Stenographer, for providing commendable secretarial support.

Chapter II

Background

II.1 In 1965, the Indian economy was passing through a period of considerable stress and Reserve Bank of India felt that there was an imperative need to preserve a 'reasonable balance between aggregate monetary flow and the availability of real goods and services'. As part of the credit policy announced on November 20, 1965, for the busy season, 1965-66, RBI, inter alia, advised all scheduled commercial banks that 'in order that the growth of bank credit may be more closely aligned to the requirements of the Plan and as an additional measure of credit regulation', they would be required to obtain the prior authorisation of RBI before sanctioning any fresh credit limit (including commercial bill discounts) of Rs.1 crore or more to any single party or any limit that would take the total limit enjoyed by such party from the entire banking system to Rs.1 crore or more on secured and/or unsecured basis. This was the beginning of what was known later as the Credit Authorisation Scheme(CAS).

II.2 The purpose and direction of bank lending in the country was further reviewed by the Dahejia Committee appointed by the National Credit Council in October, 1968. The Committee set up to examine "the extent to which credit needs of industry and trade are likely to be inflated and how such trends could be checked" pointed out the shortcomings of the security-cum-guarantee oriented system of lending and recommended that the banking system should turn to financing on the basis of a total study of the borrower's

operations rather than on security considerations alone. This recommendation was further elaborated by the Tandon Committee set up in June, 1974, to frame guidelines for follow-up of bank credit.

II.3 The Tandon Committee which submitted its final report in August, 1975, recommended radical changes in the system of bank lending, with particular reference to meeting working capital needs of industry. The Committee's recommendations emphasised a shift from the erstwhile security-oriented system of lending to production-oriented system of lending to the industry. It recommended among others certain norms for holding of inventory/receivables to facilitate meeting genuine credit needs of the industry while at the same time preventing pre-emption of scarce bank resources by the large industry. Important among these recommendations were the following :

- (a) The Committee suggested inventory & receivables (Current Assets) norms in respect of 15 major industries for the purpose of assessment and sanction of short-term bank credit for financing working capital needs of industrial units with aggregate credit limits in excess of Rs.10 lakh from the banking system (Note : Norms are being reviewed periodically by the Reserve Bank of India, as stated later, and as on date norms have been evolved for 53 industries).
- (b) The Committee suggested three ways to assess the maximum permissible bank finance. These three methods of lending envisaged different levels of contribution from the long-term funds of the borrowing units with a view to progressively reduce dependence on short-term bank borrowings. It was recommended that starting with the first method of lending there should be a gradual move towards adoption of the third method of lending which envisaged a comparatively higher contribution from the net working capital of the borrowing units (Note : Though the Committee recommended three methods of lending, Reserve Bank of India did not accept (and has so far not accepted) the recommen-

dation to adopt the third method of lending for assessment of the maximum permissible bank finance(MPBF)).

- (c) The Committee suggested annual review of the accounts to appraise the performance and assess the working capital needs for the next year.
- (d) In order to ensure planned and proper end-use of funds as also prudent deployment of scarce resources, it was recommended that the financing should be placed on a quarterly budgeting-reporting system for operational purposes.

II.4 More or less simultaneously the concept of lending under consortium arrangement was introduced in Indian banking by RBI in August, 1974, with the objective of dispersal of risk and sharing of resources by banks with particular reference to lending to large borrowers. Since introduction of lending under consortium arrangement, RBI has impressed periodically upon banks the need for expediting the formation of consortium arrangements in cases where multiple banking was in existence. Banks have been advised periodically to introduce suitable systems and procedures to ensure reduction in time taken by them for processing the credit proposals, i.e., not to put the borrowers to inconvenience through delays, their having to deal with several banks, execution of varied types of documents, etc.

II.5 The system of cash credit was further reviewed in 1979 by the Working Group (Chore Committee), which analysed the comparative merits and demerits of the cash credit, loan and bill systems. The major recommendations of the Chore Committee were as under :

- (a) The existing system of extending credit by way of a combination of cash credit, loan and bill should be retained subject to, wherever possible, the use of cash credit being supplanted by loans and bills.

- (b) The Committee recognised the need for reducing the over-dependence of the medium and large borrowers on bank finance and recommended gradual reduction of borrowing units' dependence on bank finance for build up of Current Assets.
- (c) Borrowing units not in a position to comply with the second method of lending be sanctioned working capital term loan at a higher rate of interest for their excess borrowings over and above the MPBF arrived at on the basis of the second method of lending.
- (d) The lending norms should be continued to be made applicable for borrowing units enjoying limits of Rupees 10 lakh and above (except sick units) and units with limits of Rupees 50 lakh and above were to be brought under the second method of lending (unless specifically exempted).
- (e) The recommendation of the Tandon Committee relating to the style of credit in terms of which differential rates of interest were to be charged for the demand loan and cash credit components was discontinued.
- (f) The Chore Committee simplified and rationalised the statements under the Information System and this was made applicable to all borrowers having aggregate working capital limits of Rupees 50 lakh and above.
- (g) The Chore Committee also laid considerable emphasis on regular annual review of accounts as an inherent part of the financial discipline for continuance of the cash credit system.

II.6 Thus under the CAS, then in vogue, the aim was to closely align the growth of bank credit to the requirements of the 5-Year Plans and to use CAS as an additional measure of credit regulation. The objectives of CAS were :

- (a) To ensure that additional bank credit is in conformity with the approved purposes and priorities and that the bigger borrowers do not pre-empt scarce resources;
- (b) To enforce financial discipline on the larger borrowers, where necessary, on uniform principles;
- (c) Where a borrower is financed by more than one bank, to ensure that the customer's proposal is assessed in the light of the information available with all the banks; and

- (d) To bring about improvement in the techniques of credit appraisal by banks and their system of follow-up.

Thus, by broad-basing the objectives of CAS, an attempt was made to enlarge its scope with a view to ensuring a greater degree of credit discipline on the part of the banks as well as borrowers.

II.7 In order to bring about uniformity in the implementation of cash credit system including lending under consortium arrangement, a Standing Committee by name 'Committee of Direction' has been in existence in RBI since April, 1975, and as decided by this Committee a quick study was conducted in 1987 by a study group appointed by RBI to assess the progress made in the implementation of the then existing guidelines issued to banks on lending under consortium arrangement. The study revealed that instances of non-compliance in the matter of conduct of joint appraisal, application of uniform terms and conditions, exchange of information, holding of meetings, level of representation in the meetings, sharing of ancillary business, etc., had been persisting and these had contributed to inordinate delays causing hardship to borrowers. The instructions on consortium lending were, therefore, made mandatory in June, 1987. While a gist of the guidelines is set out in Appendix IV, the main aspects of the present extant guidelines sought to be reinforced are as under :

- (a) The formation of consortium is obligatory for borrowers with multiple banking facilities enjoying aggregate fund-based working capital limits of Rs.5 crore and more from the banking system ;

- (b) The bank, which is the largest lender, should take the initiative to form the consortium ;
- (c) The formation of consortium also becomes obligatory in cases where exposure of a single bank to a borrower and/or a group of borrowers exceeds either the ceiling on that bank's exposure in relation to its capital fund ;
- (d) The number of banks in a consortium would not ordinarily be more than five and in case of credit limits in excess of Rs.50 crore more than ten ;
- (e) The appraisal of credit proposals is to be undertaken by the lead bank, where its share is more than 50 per cent of the fund-based limits or by the lead bank jointly with the member-bank having the next largest share in the limits. The exercise of appraisal is to be completed preferably within one month from the date of receipt of the loan proposal/appliation and definitely within two months. The appraisal note is required to be circulated among member-banks at least 10 days before the meeting convened to discuss on it and decide upon the terms and conditions, documentation, etc. ;
- (f) The operational problems arising out of implementation of the guidelines/instructions should be sorted out expeditiously in a manner mutually acceptable to the members of the consortium ;
- (g) In case of dispute among the member-banks on the quantum of MPBF, interest rate, terms and conditions to be imposed (which are to be uniformly applied), or any other matter pertaining to the borrowal account, the views of the lead bank and the bank having the second largest share of the fund-based limits should prevail ;
- (h) In case of sick/weak units existing member-banks would not leave the consortium and all the financing banks would be obliged to associate themselves with the rehabilitation programme ; and
- (i) It would not be permissible for any bank outside the consortium to extend any credit facility by way of bill limits, guarantees/acceptances, letters of credit, etc., or open current accounts for the borrowers without the knowledge and concurrence of the members of the consortium.

II.8 In order not to put borrowers to inconvenience through delays in having to deal with several banks in the matter of execution of documents, a single set of documents evolved by the Indian Banks' Association was circulated in February, 1989, to banks for adoption. The member banks are required to vest adequate authority with the lead bank to enable the latter to execute the documents with the borrower on behalf of the consortium.

II.9 In spite of steps taken by RBI periodically to review as also to update the guidelines by being receptive to the problems faced by both banks and industry, complaints have also been received by RBI regarding difficulties faced by borrowers relating to timeliness in disposal of credit proposals and provision of adequate credit. This has resulted in borrowers taking recourse to other available sources of finance as also from banks outside the consortium. In the view of the borrowers, the delays on the part of dealing banks/consortium in providing need-based credit coupled with the restrictions imposed on banks not to extend credit to borrowers, who are not their regular customers/outside the consortia, have hindered the flow of timely and adequate credit and, therefore, the instructions on the subject need more flexibility. In the view of bankers, the consortium discipline had served well the interests of both the industry and bankers. They, however, feel that since borrowers in India are still substantially dependent on bank credit and with the current liberalisation in

the economic policies, the banking system needs to gear up to cater to the increased volume of business in terms of number of borrowers and to meet the sophistication in financial products demanded by them.

II.10 The advantages and disadvantages of the present system of lending under consortium as perceived by industry and banks are succinctly enumerated below :

(a) Advantages

- (i) The system provides a uniform methodology for determining the working capital needs of borrowers.
- (ii) It provides for orderly sharing of risk and security among the lenders.
- (iii) It provides a forum for the lenders to exchange critical information about the borrower.
- (iv) It ensures continuity and certainty for the borrower in securing working capital finance.
- (v) It seeks to instil discipline in the borrower in managing his finance.

(b) Disadvantages

- (i) The system needs more flexibility to respond to the constantly changing business needs of the borrower and the lenders.
- (ii) Instances have been cited of inordinate delays in sanction and disbursement of credit to a borrower.
- (iii) The system does not provide enough scope to the borrower for changing the composition of the consortium. The system also does not help in generating competition among banks.
- (iv) It does not provide flexibility to borrowers in having access to credit from a bank outside the consortium at competitive prices.
- (v) The single window document, which has been evolved, is not being adopted by all banks. Banks are unable to fall in line with the single window documentation as it seeks to vest the lead bank with unfettered powers.
- (vi) The command position of the lead bank in terms of its share held in the fund-based limits of a borrower has resulted in smaller banks not being able to lend to large borrowers of repute.

- (vii) The system does not provide for exit by existing members of the consortium without the consent of the remaining members and the borrower; it does not provide freedom to the bank choosing to move out of the consortium when, according to its own perception, there is a deterioration in the credit standing of the borrower.

II.11 Both industry and banks have also put forth before the Committee the need for assessment of working capital limits based on the peak and normal requirements of a borrower in unison with the production cycle and marketing arrangement for his product instead of on the basis of quantitative norms evolved by the Tandon Committee for various industries. The views of industry and banks in the matter are summarised below :

- (i) The lending discipline evolved on the basis of recommendations of the Tandon/Chore Committee, as modified from time to time, has become outdated in the fast changing socio-economic environment.
- (ii) Even if quantitative norms are used as a guiding principle for determining the reasonable level of build-up of current assets for an industry, no separate sub-norms should be fixed for each item of current asset.
- (iii) The norms should be flexible taking into account the fortunes of the industry which, to a large extent, fluctuate with changes in Government policies.
- (iv) The existing guidelines on computation of MPBF discriminate against an efficient borrower. As the borrower's entitlement to MPBF is based on historical data, a borrower who has efficiently controlled his inventory and receivable levels suffers as against the borrower who has consistently/persistently been inefficient in managing inventory/receivables.
- (v) It has created a system of entitlement for borrowers with too much importance to their financial needs in disregard to their credit standing. Borrowers have come to assume that they are entitled to borrow 75 per cent to 80 per cent of their current assets from banks irrespective of their creditworthiness, source of repayment and ability to repay.
- (vi) It has introduced permanency to working capital borrowings. Borrowers have come to assume that working capital borrowings will never have to be repaid. Lending in the form of cash credit with no repayment plan has made the borrowers complacent but has put the resource planning of banks in disarray.

Chapter III

Different alternatives/views to the existing system

III.1 As indicated in Chapter I, views and suggestions were obtained from both industry and banks as also from others so as to facilitate deliberations in the Committee on the terms of reference.

III.2 In order to overcome the difficulties in the existing system, as stated in Chapter II, it has been opined by one segment of industry that mere carrying out of reforms or fine-tuning in the existing system would not be helpful. It has rather been suggested that the consortium approach should be abolished altogether and market forces should determine the ground rules for lending. Another segment of industry has expressed the view that though the existing system has become somewhat inflexible, it should be continued and the lead bank should even tie up the entire requirement of bank finance of a borrower. However, with a view to introducing some further in-built flexibility into the existing system, this segment of industry has suggested the following modifications thereto:

- (a) Banks should gear up their administrative machinery to convey decisions on credit proposals within a period of 45 to 60 days;
- (b) The single window documentation should be adopted by banks without any further delay ;
- (c) The threshold limit for formation of a consortium for borrowers enjoying multiple banking facilities should be raised to Rs.25 crore from the existing limit of Rs.5 crore ;
- (d) The restriction on the number of members in a consortium should be done away with ;

- (e) Bankers should have the freedom to choose their borrowers and vice versa;
- (f) While the terms of lending should be uniformly applied in so far as the cost of credit is concerned, banks should be given freedom in pricing cost of other services; and
- (g) Borrowers should be free to have access, at least for non-fund based facilities, to banks outside the consortium.

III.3 In the view of banks, the market is not yet ready for a total liberalisation of the lending system. They have, therefore, advocated continuance of the consortium approach subject to certain modifications, till such time as the prudential norms prescribed for capital adequacy, income recognition and asset classification take firm root. They are generally in agreement with industry for prescribing a specific time frame for disposal/decision of/on proposals and implementing the single window documentation. However, there was divergence of opinion amongst the banks in regard to pricing and freedom of exit from/entry into consortia. While some of the banks are in favour of continuance of the existing system, others feel that pricing should be freed and consortium arrangements should be entered into for fixed periods of say two to three years or till the expiry of the period for which the facilities have been initially sanctioned, and thereafter banks should have the option to move out of the consortium or to continue as member/s. It has also been suggested by majority of the banks that the threshold limit of Rs.5 crore for formation of a consortium for borrowers enjoying multiple

banking arrangements should be raised to Rs.10 crore and the present restriction on the number of members in a consortium should be withdrawn. While most banks feel that a borrower should not have access to bank/s outside the consortium for additional facilities, a few others are in favour of availment of export credit and non-fund based facilities by the constituent borrowers from bank/s outside the consortium.

III.4 Apart from industry and banks, certain other experts in the field presented their views before the Committee, suggesting various alternatives to replace the system of consortium financing. The alternatives suggested are as under :

- (a) Syndication of loans at least in the case of highly rated corporate borrowers eligible to issue commercial paper ;
- (b) Widening the scope of inter-bank participation certificates by making them transferable and removing the limitations relating to quantum and the period for which they can be issued ;
- (c) Modifications in the existing consortium approach in terms of freedom in the matter of pricing and in the choice of banks and borrowers with the stipulation that the stake of each member-bank should at least be 5 per cent of the fund-based facilities extended to a borrower subject to a minimum of Rs.1 crore ; and
- (d) Securitising working capital facilities as prevalent in the developed markets of the West as the flexibility that commercial paper can offer in terms of pricing and diversification of risk is absent in consortium lending.

Chapter IV

Merits and demerits of suggested alternatives

IV.1 The approach of the Committee has been to examine the strength and weakness of the existing system and hence to suggest measures for improving the system of delivery of credit. Thus, while examining the difficulties and suggestions, the Committee has distinguished between the issues related to policy, issues related to operative instructions and issues related to implementation of operative instructions.

IV.2 The Committee observes that the contentious issue between the banks and industry of the adequacy of working capital finance to borrowers, particularly, large borrowers, has been argued in terms of perceived rigidities in calculating maximum permissible bank finance (MPBF) and in lending under consortium arrangement. The Committee recognises that in the absence of developed financial market in India banks tend to follow lending discipline rigidly ~~xxx~~ so as to avoid taking too much of risk. In countries with strongly developed financial systems, banks can conveniently diversify their risks on working capital finance and such diversification occurs through markets for short-term financial instruments .

IV.3 Risk in providing working capital can broadly be divided into the risk of size, the risk of capital loss and the systemic risk associated with changes in national economic and banking policies. Thus while considering in this Chapter the various suggestions received from banks, industry and others for modification and/or replacement of the existing policy/instructions on lending under consortium arrangement,

the Committee has also considered possible measures/new financial instruments for banks to diversify/to minimise their risks. As a corollary the Committee has also deliberated upon the extant guidelines issued to banks for arriving at MPBF, though the subject matter is also being dealt in by another Committee (presided over by Shri Jilani, Chairman and Managing Director of Punjab National Bank) as also the In-House Group constituted by RBI.

IV.4 The Committee is also aware of the fact that till in the recent past several borrowers were able to draw finance far in excess of their reasonable working capital requirement/MPBF by obtaining finance from banks outside the consortia (and/or from non-bank sources) either through discounting/rediscounting of accommodation bills or other methods and which prompted RBI to issue directives in July, 1992 (as stated in Chapter I).

IV.5 During discussion in the Committee, members have also observed that in countries with developed financial markets working capital finance for large and medium-sized borrowers is being increasingly securitised. The Committee has also observed that borrowers can have access to other sources of finance such as commercial paper, long-term market borrowings (viz., debentures), etc. These alternatives have also been discussed in this Chapter with the idea of evolving a system that will not only suit the needs of the industry and banks but will also ensure observance of financial discipline by borrowers. While evolving the system, the Committee also recognises that irrespective of the system

unless credit is sanctioned and disbursed in time, it will not achieve its desired effect. In essence, the Committee is of the view that any system of lending based on the fundamental principle of sharing of risks and resources (Banks with their limited resources and capital adequacy prescriptions cannot afford unrestricted exposures) should have the following attributes :

- It should ensure proper dispersal of risk
- It should ensure timely provision of credit
- It should meet the need-based requirements of a borrower
- It should enforce financial discipline on the borrower
- It should be operationally convenient to banks as well as to borrowers
- The cost of administering the system should not be a burden on the banks or on the borrowers

IV.6 The Committee observes that the last decade has witnessed significant diversification and sophistication in the Indian financial sector with the emergence of several new money market instruments as adjuncts to bank credit. A brief description of each of these instruments as practised in India, follows in the ensuing paragraphs.

(a) Inter-bank participation certificates

The system of raising finance through inter-bank participation certificates as in operation at present is restricted to borrowers with health code classification I and the finance that can be arranged through these certificates is limited to the extent of 40 per cent of the outstandings in the borrowal account at the time of issue. The participation certificates are not transferable and their

tenure is for a minimum period of 91 days and a maximum period of 180 days. Apart from the restricted scope and coverage of participation certificates, in the absence of any compulsion on the part of any bank to accept participation certificates, the bank/s intending to share even good and satisfactory advances with other bank/s are not assured of a ready market for such certificates. The Committee is, therefore, of the view that interbank participation certificates cannot entirely replace the existing system of lending on consortium basis under which the member banks are required to take care of the needs of borrowers, when in distress.

(b) Commercial Paper

At present, only highly rated corporate borrowers can have access to the market for issue of commercial paper up to 75 per cent of the fund-based working capital limits sanctioned to them. While this mode of raising finance cannot be used for meeting the entire working capital needs of even the highly rated borrowers, it is not at all available to borrowers with relatively lower rating, who constitute the bulk of the banks' clientele. It is also not available to borrowers with sanctioned fund-based working capital limits of less than Rs.5 crore. Further, commercial paper cannot be issued beyond six months' duration. The Committee is, therefore, of the view that commercial paper in its present form is a source of finance available only for a select group of borrowers and that too for period not exceeding six months and cannot substitute the system of consortium financing

which can be availed of by all categories of borrowers.

(c) Debentures

The existing legal framework permits public limited companies and public sector companies to augment their long-term sources for meeting working capital requirements by issue of secured convertible and non-convertible debentures to the extent of 20 per cent of their gross current assets, loans and advances subject to their maintaining a minimum debt-equity ratio of 2:1. While this mode of raising finance is designed to meet mainly the core portion of the current assets of the concerned companies, they will have to depend on other sources for the variable portion of their working capital requirements. The Committee, therefore, believes that issue of debentures is a supplementary source of finance and is not the solution to the problem.

(d) Securitisation of debts

One of the factors impelling banks and financial institutions to enter into consortium arrangements for the purpose of lending is that their resources are limited. It has, therefore, been argued that this problem could be reduced, if not solved, by augmenting their resources through securitisation of debts so that the system of consortium funding can be given up. Securitisation of debts is a process of removing assets from the balance sheets of the lending institution by selling these assets to investors in the form of securities backed by such assets. The sale is normally without recourse to the seller and hence payment to investors is made to the extent of cash flows realised from the underlying assets.

The proceeds of sale of the assets generate additional capital to the issuer at a lower cost thus increasing his net owned funds. Thus, securitisation enables an issuer to depict a better financial position in his balance sheet. The investors on their part can choose securities which conform to their preference in terms of maturity, risk and average lives. To meet the investors' choice, the assets to be securitised must be of high quality with proper rating by recognised rating agencies and a clearly defined repayment programme. Besides, suitable legislative changes are necessary for transfer of risks and benefits underlying the asset to the investor. It is because of the absence of these attributes that a secondary market for such assets is yet to develop in India. However, a modest beginning has been made to raise resources by securitisation of assets in the form of automobile, real estate and housing loans and to some extent commercial and industrial term loans. The current assets of manufacturing companies are in the nature of inventory/receivables and, therefore, do not satisfy the pre-requisites for securitisation. The Committee is, therefore, of the view that securitisation is not the appropriate method of increasing the resources of banks or replacing the working capital requirements of borrowers in the prevalent condition.

(e) Syndication of credit

A syndicated credit is an agreement between two or more lending institutions to provide a borrower credit

facility utilising common loan documentation. A prospective borrower intending to raise resources through this method awards a mandate to a bank commonly referred to as Lead Manager to arrange credit on his behalf. The mandate spells out the commercial terms of the credit and the prerogatives of the mandated bank in resolving contentious issues in the course of the transaction. The mandated bank is required to prepare an information memorandum about the borrower in consultation with the latter and distribute the same amongst the prospective lenders soliciting their participation in the credit to be extended to the borrower. The mandated bank does not sell the credit risk but presents an opportunity to lend by extending an offer containing terms agreed between the mandated bank and the borrower. The information memorandum provides the basis for each lending bank making its own independent economic and financial evaluation of the borrower, if necessary by seeking additional supporting information from other sources as well. Thereafter, the mandated bank convenes a meeting to discuss the syndication strategy relating to coordination, communication and control within the syndication process and finalises deal timing, charges towards management expenses and cost of credit, share of each participating bank in the credit, etc. The loan agreement is signed by all the participating banks. The borrower is required to give prior notice to the Lead Manager or his Agent for drawing the loan amount to enable the latter to tie up disbursements with the other lending banks. While syndication is very similar to the system of consortium lending in terms of dispersal of risk, the freedom the borrower has

in terms of competitive pricing and the discipline that is sought to be achieved through a fixed repayment period under syndicated credit are absent in the present system of lending through consortium arrangement. Thus, syndication of credit is a convenient mode of raising long-term funds by borrowers with high credit standing only and cannot supplant the system of consortium lending for meeting the fluctuating and current transaction needs of borrowers in general.

IV.7 The emerging scenario from the foregoing analysis is that each of the suggested alternatives has certain distinct advantages as well disadvantages. Because of the individual characteristics of these alternatives, none of them can be considered as fully complementary to other/s in meeting the entire working capital needs of a borrower either singly or taken together. The shift towards a market-driven economy is a gradual process and the market is not yet ready for a total liberalisation of the lending system.

The Committee feels that the alternatives discussed above can co-exist and supplement the system of consortium lending with certain modifications. The Committee, therefore, suggests that while a beginning could be made in liberalisation by enlarging the scope of inter-bank participations and commercial paper together with introduction of syndication of credit on a selective basis, the system of consortium lending with its intrinsic advantages should be retained by making it more responsive to the needs of borrowers without diluting the financial discipline. The recommended system has been set out in Chapter VIII.

Chapter V

Observations

V.1 The genesis of commercial banking perhaps evolved in India with the arrival of the British. They introduced over a period of time the type of commercial banking, which evolved in London out of the business of the goldsmiths during the seventeenth century. Such banking in London was mainly dependent on the close relationship between the businessmen and their bankers and bank lending was based on confidentiality and personal equation.¹ This type of banking invited comments from different quarters and it may be of interest to note what was observed by Keynes as quoted in the Money Lenders by A.Sampson : "A 'sound' banker, alas ! is not one who foresees danger and avoids it, but one who, when he is ruined, is ruined in a conventional and orthodox way along with his fellows, so that no one can really blame him."

V.2 Banking in India had for a long time been a regulated industry and, perhaps, will continue to be so in future as well. While regulations per se can not be termed unnecessary, too many regulations have also resulted in complete loss of freedom, leaving no scope for market mechanism and innovations in banking and financial services. Another avoidable effect of too many regulations has been the tendency to avoid and/or to overstep the regulatory directives by banks to meet the requirements of their clients. Thus for example there are instances of banks providing bill finance outside the consortium to some of the large borrowers in the name of suppliers' credit against corporate guarantee.

1. Men, Money and Goods by J.S.Gamb

V.3 Another type of banking that is being practised in India since 1970 (in addition to the pure financial intermediation and regulatory banking) is the role envisaged of banks as 'change agents' in promoting economic growth. Thus with introduction of development banking network of bank branches was fast expanded and banks have been required to allocate credit to agriculture and hitherto neglected sectors of the economy. In this connection the Committee observes that an earlier Committee (The Committee on the Financial System presided over by Shri M.Narasimham) had recommended that such directed credit programmes should be phased out except for certain sectors. This Committee, however, observes that the recent announcements on credit policy by the RBI indicate that such directed credit programmes will continue, at least for some more time.

V.4 During the latter part of mid-80's, the banking industry in India witnessed radical transformation in terms of wide range of services offered and keen competition faced by banks in mobilising savings of the community. With a wide proliferation of financial instruments offering attractive rates of return together with fiscal concessions attached to each, banks had to evolve innovative methods to mobilise savings from the household sector.

V.5 There is global awareness that the banks and financial institutions have been too constrained by the existing regulations as also the increasing demands on them to meet all sorts of financial needs has thus resulted into a new approach in banking. The adoption of market-oriented approach

has also been accelerated by the need for earning more profits as also by the advent of new technology. The other major factors responsible for the new approach are :

Reorientation of demand for financial services and need for innovation of new services to meet them;

New concept of money management with gradual move towards minimum demand deposits and/or cash inventory;

Emergence of a high degree of competition, particularly, triggered by aggressive marketing techniques;

New trend of disintermediation resulting in banks now required to offer services in hitherto non-traditional non-banking financial activities like merchant banking, investment banking, mutual funds, venture capital, etc.;

Securitisation by way of a shift in the preferences of the household sector for financial assets;

Gradual decline of the 'individual investor' together with increasing trend of institutionalisation of investment by the household sector in the business sector; and

Globalisation of banking or transnational banking.

The success of the new trend in banking all over the World as also in India, therefore, depends very much on -

- freedom for bankers to act,
- vigorous competition for business and profits,
- sharper customer orientation, through product and service innovation, and
- better management through better linkages between goals, strategies, organisational

structures, systems and technological change.

V.6 With the above emerging scenario in banking, the suggestions received and discussion on 'merits/advantages' and 'demerits/disadvantages' of alternatives to lending under consortium arrangement (Chapter IV *ibid*), the Committee is of the view that ultimately the market forces should have greater role, if not the only role, in deciding allocation of resources. Thus while suggesting an alternative system in the interregnum, i.e., till totally market-oriented banking system becomes practicable, the Committee has taken note of the shortcomings in the existing system and suggested changes to overcome these shortcomings.

Chapter VI

Lending Norms and Guidelines

VI.1 In India the supply of credit has been controlled through credit policies announced periodically by Reserve Bank of India. The effects of these policy measures have been aimed mainly towards

- (a) changing the amount of liquidity in the economy; and
- (b) direct controls over both the amount and type of credit,

among others. Liquidity in the economy has been varied chiefly by influencing the liquidity of the banks through rate of interest and other direct controls.

VI.2 Direct controls

Banks have been advised to follow lending guidelines based upon which they should operate their 'rationing' policy. Banks are required to discriminate between different types of borrowers. However, while banks are the main source of liquid funds and the level of their deposits will have a big effect on the flow of money income, they are not the only source. As a result, because of limitations imposed on the banks, there has been development of other sources of credit - 'near' money. Thus, as bank lending became tighter, borrowers turned to various 'spill over' sources.

VI.3 Norms for inventory and receivables

As stated in earlier Chapters, one of the major complaints of trade and industry has been against the use of norms for inventory and receivables by banks while assessing

maximum permissible bank finance (MPBF). They are of the view that these direct control measures forced them in the past to seek credit from other sources. As a result they have demanded scrapping of these norms.

VI.4 The Committee is also aware of the fact that quite often banks are unable to process the loan proposals in time as also sanction additional working capital finance and/or renew existing limits because the borrowers do not furnish the required data and statements (viz., monthly stock statement, monthly statement of debtors and creditors, monthly statement of sales and purchases, monthly operation data and Quarterly Information System Forms I, II and III, etc.) on time. After all no bank will want its good clients to go out of its fold, while at the same time for healthy conduct of their business financial discipline is very essential.

VI.5 While there are no doubt certain advantages of direct control measures (viz., these can be introduced or changed quickly, the effects of changes are quickly felt, these can be discriminatory, etc), there are also certain disadvantages associated with them. For example, activity tends to be frozen into existing channels, a cumbersome organisation is required to implement them, the extent to which discretionary powers can be used is limited (and sometimes such use may be based on subjective decisions), controls are effective only in limiting expansion, certain controls tend to discriminate among the borrowers, etc. As a result often ways are found to circumvent the controls. Thus while borrowers do not find a perfect market (in that they can obtain all the funds

they require at going market-rates), they do find other sources, though they are put to the extra trouble of 'negotiating' a loan.

VI.6 The Committee is, therefore, of the view that while controls over the availability of credit may be useful in the short run and have the advantage that they can be discriminatory, they can not also be regarded as a permanent alternative to other measures. The reason is that, in the long run, controls are not effective in limiting the total flow of consumption and investment spending.

VI.7 Thus while there is no problem faced in general by good borrowers in obtaining adequate working capital finance in time, other borrowers, particularly, those faced with problems like bunched receipts of raw materials, delayed receipt of payments, etc., find it difficult to obtain additional bank credit.

VI.8 The Committee is also aware of the fact that flexibility in-built in the extant guidelines for lending is not taken advantage of for different reasons. The Committee, therefore, feels that changes are necessary in the extant guidelines to make these simpler and more flexible so as to enable banks to meet sudden and additional requirement of credit, whether banks provide the same individually, or by way of consortium/syndication.

VI.9 Reserve Bank of India(RBI) has constituted an In-House Group to review comprehensively the role of RBI in laying down norms, etc., for bank lending for working capital purposes.

The Committee, therefore, refrains from examining in depth such changes as are necessary to make the extant guidelines on lending simpler and more flexible except for recommending that these norms and other measures indicated by the RBI should henceforth be regarded as broad guidelines and the application of lending and inventory norms be left to the discretion of individual banks/consortia/syndicates.

Chapter VII

Single Window Concept of Lending by banks - Documentation

VII.1 One contentious issue among banks has been their inability to execute only one set of documents while extending working capital finance to a borrower by consortium of banks. It may be reiterated that Reserve Bank of India advised banks in August, 1988, to follow certain instructions for its implementation. The objective behind introduction of single window concept of lending (SWCL) documentation was to avoid delay and inconvenience to the borrowers, as under this arrangement the lead bank in all consortium arrangements should have the authority from each of the other member banks to make available their shares of the entire/enhanced limits if latter's decision was not conveyed to the lead bank in time. Further, the borrower is required to execute only one set of documents, which is to be signed by the lead bank on its own behalf and on behalf of other members. A set of model documents (evolved by the Legal Committee of the Indian Banks' Association) was subsequently (February, 1989) circulated by the RBI for adoption by banks.

VII.2 However, these documents were not acceptable to foreign banks, particularly, banks having their Head Office in the United States of America. These banks had expressed difficulties in executing the power of attorney in favour of lead bank empowering the latter in the matter of taking credit decisions on behalf of the member banks.

VII.3 Since sanction and disbursement of credit in time as

also execution of a single set of documents are desirable from the viewpoint of both borrowers and consortia, the Committee requested Indian Banks' Association to constitute a 'Small Group' and examine/review the existing set of documents and hence recommend a revised set of documents acceptable to all banks.

VII.4 The Committee is happy to note that the 'Small Group' was able to complete its task creditably within a very short period and wishes to record its appreciation for the same.

VII.5 Major changes recommended are as under :

- (a) The inter-se agreement has been made the main agreement and accordingly the letters of authority, vesting powers in the lead bank and bank with the second largest share, have been so modified as to provide for the lead bank taking such decisions and actions as agreed upon in the inter-se agreement.
- (b) Certain clauses have been so recast as to give all the members of the consortium the right to make a credit decision in financing both healthy units and sick/weak units under rehabilitation. Thus member banks will have the discretion to take on additional limits and a bank can in future opt out or reduce its share (by offering it to the other member or to a new bank permitted to join the consortium) subject to certain conditions.

VII.6 The changes recommended by the Small Group focus on the following aspects :

- (a) A member bank has the right to make its own credit decision on taking up enhanced share in financing a borrower under consortium.

- (b) Directions/instructions to be issued by the lead bank/bank with the next largest share in terms of powers vested in it under the inter-se agreement would be in consultation with the consortium and represent the consensus views of the members.
- (c) In the case of sick/weak units under rehabilitation a member bank would have to continue its share without demur (if it cannot transfer/discount it). Further, in case it does not take up the additional facilities under the package, the repayment of its dues would be deferred till the dues of other members are repaid in full.

VII.7 In terms of extant guidelines banks are normally required to take up the enhanced shares allotted to them in a consortium based on the existing pro-rata sharing basis unless they have constraints of funds in which case a guarantee could be executed by such a bank favouring another bank taking up its share until its funds position improves. Also, while the consortium should come to a mutually acceptable decision on the proposal, in cases of difference among members, the views of the lead bank/bank with next largest share shall prevail. The Committee is of the view that this was one of the contentious issues on which the single window documentation could not be implemented by banks. Further, with the present guidelines setting out norms for capital adequacy, income recognition and prudential exposure, it may not be possible to unilaterally enforce that a member should take up its

additional share. While the Committee agrees that in order to ensure discipline, the entry into/exit from consortia should continue to be regulated by the lead bank/consortium as hitherto in conformity with the guidelines for transfer of borrowal accounts, banks should have the freedom to take up enhanced shares based on their credit decisions. The Committee while agreeing that the lead bank with the largest share in an account should have a say in the matter, also recognises that the consensus view of members/majority view would be a better approach as happens in the case of syndicated loans. The Committee also observes that another factor deterring the implementation of the SWCL documentation relates to the requirement that banks should participate in rehabilitation packages of potentially viable units. The Committee feels that in accordance with permitting banks to make credit decisions, the bank can transfer/discount its debt or rank last in having its dues repaid.

VII.8 The Committee is aware of the acceptance of the revised set of documents (evolved by the Working Group of Indian Banks' Association) by the Managing Committee of IBA. The Committee observes that use of the revised set of documents must be preceded by certain amendments in the extant guidelines issued by RBI on lending.

Chapter VIII

Recommendations of the Committee

VIII.1 Evolution of the consortium arrangement for lending as also present set of guidelines has been indicated in details in Chapters I & II and Appendix IV. The Committee observes that the idea of lending under consortium arrangement was mooted not only as a way to avoid the delays and risks involved in multiple lending, but also to allow the smaller banks to participate in the benefits to be obtained from lending to large and good borrowers. However, these banks having smaller shares in the consortia have often refused in the past to abide by the lead bank's directives. This has been particularly true for foreign banks, who have shown more preference for non-fund business compared to their participation in fund-based limits. This scenario was also a result of delay/slow decision-making process on the part of the consortia.

VIII.2 While the first issue will be non-existent under syndication arrangement of credit, the Committee feels that the issue of delayed decision cannot be eliminated unless borrowers realise the importance of submitting financial and other statements to banks in time and banks gear up their grass root level functioning as also take advantage of modern technology.

VIII.3 Consortium or Syndication

As already stated in paragraph IV.7 in Chapter IV and paragraph V.6 in Chapter V, the Committee is of the

view that a total shift to market-driven banking can take place in a gradual/phased manner. The Committee is also aware that in the interregnum the present set of guidelines needs more flexibility to get over some practical difficulties like inability of banks to take quick decision either on account of delayed receipt of data and information from borrowers or on account of lack of delegation of power to Officers attending consortia meetings, unwillingness on part of member-banks in a consortium to accept credit-related decisions made by the lead bank, non-execution of common set of documentation, ban on free entry or exit of a member-bank into or from the consortium, etc. To overcome these problems the Committee recommends certain changes (as stated later in this Chapter) in the extant guidelines on lending under consortium arrangement together with introduction of syndication arrangement.

VIII.4 The Committee also deliberated at length on some of the other issues relating to free pricing of credit facilities by individual banks, total freedom in the matter of entry into/exit from consortium and availment of certain credit facilities like discounting of bills, export credit and non-fund based requirements outside the consortium arrangement. The Committee observes that some of these suggestions can not be accepted in toto in the interest of ensuring financial discipline on the part of borrowers and healthy growth of the banking system in India.

VIII.5 Lending Norms and Guidelines

The Committee is of the view that the present set of guidelines needs more flexibility so that the borrowers and lending banks have the freedom to decide the levels of holding of inventory and receivables. The Committee, however, refrains from examining in depth the changes necessary to bring about more flexibility to the extant guidelines for reasons stated in paragraph VI.9 in Chapter VI. The Committee nevertheless recommends that these norms and other measures should be regarded by banks in future as broad guidelines and the application of inventory norms be left to the discretion of individual banks/consortia/syndicates.

VIII.6 Documentation - Single Window Concept

As stated earlier in Chapter VII, the revised set of documents, as approved by the Managing Committee of the Indian Banks' Association, has been accepted by all banks. The Committee, therefore, observes that with the removal of this contentious issue, banks in a consortia should henceforth be able to considerably reduce the time taken now for sanction and disbursement of loans. The Committee, therefore, recommends that the RBI may, therefore, please adopt the revised set of documents (Single Window Concept) and consider issuing suitable instructions to this effect to the banks.

VIII.7 Threshold Limit

At present in the case of borrowers enjoying fund-based credit limits of Rs.5 crore or more from more

than one bank, consortia arrangement is obligatory. Data made available by the RBI indicates that in terms of reports made by banks to the RBI during 1992, there are about 934 borrowal accounts with sanctioned fund-based working capital limits of Rs.5 crore or more. The break-up is as under :

| <u>Quantum of fund-based working capital limits</u> | <u>Number of borrowal accounts</u> |
|---|------------------------------------|
| Rs. 5 crore to Rs.10 crore | 443 |
| Rs.10 crore to Rs.20 crore | 254 |
| Rs.20 crore to Rs.25 crore | 55 |
| Rs.25 crore to Rs.50 crore | 106 |
| Rs.50 crore and above | 76 |
| Total | <u>934</u> |

The Committee observes that there are certain advantages under the consortium system of lending as it allows lending banks to meet and discuss collectively the performance of the borrowers, exchange views and share the credit facilities to ensure financial discipline. At the same time continuing with an obligatory limit of Rs.5 crore is likely to put pressure on the banking system leading to delay in sanction/review of limits. The Committee, therefore, recommends that the present threshold limit of Rs.5 crore may be enhanced to Rs.20 crore. This increase will automatically reduce by about 75 per cent the number of large borrowal accounts to be covered by

consortium arrangement. As such banks will be able to better utilise their manpower in taking quick decisions. However, the Committee also suggests that even in respect of borrowal accounts (up to Rs.20 crore) which will not be covered by 'obligatory consortium arrangement' in future, banks, if they so desire, will be free to enter into a consortium arrangement at their option. The Committee further recommends that with more liberalisation of the economy and total structural reform of the financial sector, this threshold limit may be increased to Rs.25 crore, or above, say by March 31, 1996. The Committee also recommends that in the light of the experience gained the desirability of dispensing with the concept of threshold limit itself may be considered in due course.

VIII.8 Syndication

The Committee also suggests that in respect of borrowers enjoying fund-based working capital limits of Rs.25 crore or more from a single bank and/or more than one bank, a beginning could be made by those single banks and/or leaders of the existing consortia to make 'syndication' of the working capital limits so sanctioned. Initially this may be experimented with borrowing companies, which are rated strong or very strong by rating agencies so far as degree of safety regarding timely payment of principal and interest is concerned. Further, the system of syndication would prove more useful in case of fixed loan/working capital on one time basis.

VIII.9 Multiple Lending

Multiple lending system is always fraught with the

risk of excess financing. Thus, in the interest of credit discipline, the Committee recommends that the borrowers enjoying multiple banking facilities with fund-based working capital limits of up to Rs.20 crore, should henceforth furnish to each of the lending banks full details of the credit facilities including ad-hoc facilities availed of from the banking system, duly certified by their auditors, each time any fresh facility/enhancement is sought.

VIII.10 Number of members in a consortium

At present the number of members in a consortium should not ordinarily be more than five and in the case of borrowers with aggregate credit limits exceeding Rs.50 crore, the number may be more if the borrower so desires, but it should not exceed ten. However, as already noted presence of too many banks with small share creates problems in arriving at timely decision. On the other hand restriction on maximum number of banks does cause larger exposure for banks in cases of very large borrowal accounts. The Committee is of the view that meaningful participation in a consortium should be based on the extent of share of a member in the credit limits. Accordingly, it recommends that there is no need to stipulate any ceiling on number of banks and rather a bank intending to participate in a consortium should take a minimum share of 5 per cent of the fund-based working capital limits or Rs.1 crore, whichever is more.

VIII. 11 Maximum time-frame for disposal of proposals

At present the lead bank is required to finalise

the assessment and prepare the appraisal note as quickly as possible, preferably, within one month, but in any case within two months from the date of receipt of the application form/loan proposal from the borrower. Quite often non-availability of data or submission of incorrect data or non-receipt of required financial statements result in banks being not able to take decisions within the above-mentioned time frame, though in most of the cases decisions are taken by banks/consortia in much less time provided these data and information are made available in time by their borrowers.

VIII.12 With increase in the threshold limit for forming consortium and introduction of syndication, the Committee expects a substantial decrease (about 75 per cent) in the number of borrowers falling within the purview of compulsory/obligatory formation of consortium. It should, therefore, be possible for banks to reduce the maximum time-frame to formally dispose of loan proposals provided applications/proposals are received together with required details/information supported by requisite financial and operating statements. The Committee, therefore recommends the following maximum time-frame:

| | <u>Present position</u> | <u>Recommendation</u> |
|--|-------------------------|-----------------------|
| Proposals for sanction of fresh/enhanced credit limits | 90 days | 60 days |
| Proposals for renewal of existing credit limits | 90 days | 45 days |
| Proposals for sanction of ad-hoc credit facilities | 90 days | 30 days |

VIII.13 Maximum time-frame for sanction of credit to exporters

The Committee deliberated in details the demand of a section of the trade and industry 'that export finance should be outside the consortium framework'. The Committee observes that the main reasons cited in support of this demand are inability of banks to sanction additional limits and the delay in sanction of such limits. With changes already made by Reserve Bank of India in the extant guidelines relating to calculation of maximum permissible bank finance, the first reason is no more in existence, as evidenced by the increase in the outstanding amount of export credit by about 60 per cent from March, 1992, to May 28, 1993, outstanding amount as on May 28, 1993, being Rs.17,017 crore constituting 10.9 per cent of the total outstanding net bank credit. The Committee further observes that this significant achievement would not have been possible if there was a general delay on the part of individual banks/consortia in sanctioning export finance. Nevertheless, considering the importance of increasing country's exports, the Committee recommends the following maximum time-frame for sanction of export credit limits, which are less than what it has recommended for in other cases. The Committee, however, concurs with the unanimous view of all banks that export credit limits originally sanctioned as a part of the over-all credit limits as also the additional credit requirement beyond maximum permissible bank finance should be covered by lending under consortium arrangement and/or syndication. The recommended maximum

time-frame is as under :

| | |
|--|---------|
| Proposals for sanction of fresh/enhanced credit limits | 45 days |
| Proposals for renewal of existing credit limits | 30 days |
| Proposals for sanction of ad-hoc credit facilities | 15 days |

VIII.14 The Committee observes that one of the main reasons causing delay in credit decision is the delay in submission of the required data/information/statements. At present these include, among others, audited financial results for the last two years, estimated and projected results for the current and subsequent year respectively. As borrowers require on an average at least six months to obtain audited financial statements, they are unable to submit the same to their banks/consortia before October every year, as for majority of them the accounting year is April to March. As such, the regular credit limits cannot be sanctioned by banks before November/December every year, by which time nearly eight to nine months of operation in the current year (April to March) are over. To overcome this problem, the Committee recommends that individual banks/consortia should review the borrowal accounts during the first quarter (April to June) of the current year on the basis of audited statements for the year before last, provisional statements for the last year, provisional estimates for the current year and forecast for the next year. Consequently 50 per cent of the additional credit

requirement could be released by individual banks/consortia at their discretion during or before the second quarter (July to September) of the current year. Consequent to submission of audited results in September/October, the banks/consortia could release the remaining 50 per cent provided there is no difference of significance between the audited results and provisional estimates.

VIII.15 The Committee also observes that the success of the recommended maximum time frame will depend on the ability of the banks (besides submission of data and information in time by borrowers) to ensure that level of participation in the consortia/syndication meetings is at a senior level. Further, banks should delegate sufficient power to their functionaries attending such meetings.

VIII.16 Entry into/exit from consortium

In cases of banks/consortia not being able to adhere to the recommended maximum time-frames for sanction, the Committee recommends that borrowers will be free to bring in a new bank or new banks in a consortium. However, banks should not extend any type of credit facility to borrowers, where they are not members of the existing consortia or where such borrowers are not their regular borrowers, except with the specific approval in writing of the existing consortia/regular banks or in cases, where existing consortia/regular banks have failed to take decision on credit applications/loan proposals within the stipulated maximum period of time. In the latter cases such new banks should inform, within seven days of sanction of any credit

facility, the existing consortia/regular bankers and should not disburse the same without obtaining 'no objection' from the existing consortia/regular bankers. In case such 'no objection' certificate is not received within next ten days, it would be deemed that existing consortia/regular banks have no objection in the new bank joining the consortia/forming consortia.

VIII.17 Banks are normally required to take up the enhanced requirements of borrowers in consortia on the basis of pro-rata sharing pattern. In the case of a bank being unable to take up its enhanced share, the enhanced share could be reallocated among the other existing willing members and if this is not possible, a fresh member-bank willing to take up the enhanced share may be inducted into the consortium in consultation with the borrower.

VIII.18 While a bank may be permitted not to take up its incremental share, it cannot be permitted to leave a consortium before expiry of at least two years from the date of its joining the consortium. Further, after expiry of two years, an existing member-bank may be permitted to exit from the consortium provided other existing member-banks are willing to take its share and/or a fresh member-bank is willing to take its share by joining the consortium.

VIII.19 In cases, where the other existing members or a fresh bank are unwilling to take over the entire outstandings of an existing member desirous of moving out of the consortium after the expiry of above-mentioned period of two years, such bank

may be permitted to leave the consortium by selling its debt on discount and/or furnishing an unconditional undertaking that the repayment of its dues would be deferred till the dues of other members were repaid in full.

VIII.20 It would be open to a borrower to choose his bank/(s) for obtaining credit facilities as also for the bank/(s) to make credit decision on the borrower. However, once a consortium is formed, entry of a new member (unless mentioned otherwise in this Chapter) into a consortium should be in consultation with the consortium.

VIII.21 Terms and conditions

The extant guidelines on terms and conditions for sanction of credit facilities should continue. That is once credit facilities are extended by a formal consortium, the terms and conditions for different categories of credit facilities, as finalised at a consortium meeting, should be uniformly applied by all consortium members. These instructions will thus apply to the rate/(s) of interest for various advances, including penal rate and it will not be open to any member to waive the penal rate or vary the margin stipulated unilaterally.

VIII.22 Rate of Interest

The Committee observes that some banks are of the view that 'pricing of loans' should be left to the individual banks. The Committee is of the view that it would require some more time for the banking system in India to adopt

this mechanism completely. The Committee, however, recommends adoption of this principle for syndication of loans with the reiteration that in case of a consortium, all member-banks in the consortium will charge an uniform rate of interest for same type of credit facilities extended to the borrower.

VIII.23 Role of lead bank

The lead bank will be the final authority in case of differences of opinion among the members of a consortium, i.e., the view of the lead bank and/or the bank with the next highest share will prevail in cases of disputes among the members relating to terms and conditions. The lead bank will also be responsible for preparation of appraisal note, its circulation, arrangement for convening meetings, documentation, etc. The Committee further recommends that the lead bank will be responsible for monitoring of the borrowal account, fixing and advising shares of member-banks in the monthly and/or quarterly operative limits, etc.

VIII.24 The Committee also recognises the sudden demand for additional credit by borrowers due to contingent/emergent situation. The Committee, therefore, recommends that within the appropriate mandate governing functions of a consortium, lead bank should have the freedom to sanction additional credit by a pre-determined percentage (say 10 per cent of the regular limits or 20 per cent in case of export finance) in emergent situation as a contingent plan. The Committee

further recommends that the lead bank should inform immediately other members about such sanction together with their pro-rata share in the additional limits.

VIII.25 Fee for lead bank

In order to compensate the lead bank for services rendered to the borrower and other members of a consortium, the Committee recommends that the lead bank may charge a suitable fee (say 0.25 per cent of the limits) per annum, to be borne by the borrower.

VIII.26 Multiple divisions of a single borrower

The Committee deliberated at length on the credit arrangement for multi-divisional/multi-product companies and decided that such companies as borrowers would be treated as one single unit, unless there were more than one published audited balance sheet. Similarly, in case of merger, the Committee recommends that there should be one consortium financing the merged unit and in case of split, more than one consortium could be formed.

VIII.27 Together with the changes recommended in the extant guidelines on lending under consortium arrangement and recommended introduction of 'syndication' for working capital/term finance, the Committee recommends further liberalisation in the terms and conditions of the following existing money market instruments. Adoption of these complimentary recommendations will add to minimisation and diversification of the risk of the banking system besides accelerating the process of determining terms and conditions of short-term finance by way of market forces. The

Committee's recommendations are as under :

- (a) Commercial paper : There is further scope for companies eligible to issue commercial paper to obtain higher quantum of short-term finance through this instrument. Commercial Paper (CP) could be popularised by increasing its tenure to 360 days in addition to 90 days and 180 days, and developing an active secondary market. Stamp duty is an inhibiting factor in raising resources through CP and should be waived. The Committee has also considered the demand of industry to keep CP outside the maximum permissible bank finance (MPBF) but it does not recommend any change in the existing practice of carving out CP out of MPBF as standby facilities/restoration of credit limits provided by banks afford better investor confidence.
- (b) Debentures : The legal framework permitting public limited and public sector companies to issue debentures for augmenting their long-term sources for working capital requirements to the extent of only 20 per cent of their gross current assets, loans and advances should be reviewed to consider raising this ceiling.
- (c) Inter-bank participation certificates : Inter-bank participation certificates could be made a more effective and popular money market instrument by making it freely transferable 'with risk' and/or 'without risk' as also permitting its issue on usance beyond 90 days. Further, an active secondary market for the instrument can be created by allowing money market mutual funds to invest in them.

Chapter IX

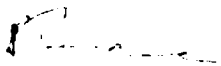
Conclusions

IX.1 The Committee recognises the important role of financial institutions and banks in the development process. It observes that absence of a properly functioning financial system hinders industrial development, given, particularly, the pervasive scarcity of private capital in a developing country. The Committee is aware that the financial system plays a crucial role in market-oriented economies in stimulating broadly based industrial development. The Committee, however, observes that unless interest rates are allowed to be set by the market, so that they reflect accurately the availability or scarcity of capital in the economy, the financial sector may not be able to effectively perform its role in meeting the changing needs of the Indian economy.

IX.2 Considering the future demand to be made on the banks, particularly, in the context of liberalisation of the economy and the emerging process of disintermediation, our recommendations are a collective attempt to meet the dual needs of the economy as also that of a healthy banking system. The recommendations are thus based on the strengths of the existing banking system while striving to improve the quality of services offered by it.

IX.3 We, therefore, not only make these recommendations, but also advocate for their immediate implementation. In case implementation of these recommendations requires prior

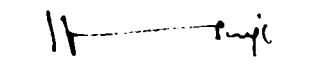
and/or simultaneous changes in the extant guidelines/
policy, we further recommend for effecting such changes
expeditiously so as to enable the banking system to
play its role effectively in the deployment of credit
for industrial development.



(J.V. Shetty)




(A.T. Pannirselvam)



(Harbhajan Singh)




(Supriya Gupta)



(G.C. Dobby)



(Jean Claude Tremosa)



(P.K. Biswas)

Bombay
August 21, 1993

Reserve Bank of India
Industrial & Export Credit Department
Central Office, Bombay
Policy and Monitoring Division

Memorandum

Trade and industry have been voicing their concern for some time that it has been difficult for them to comply with the existing norms and procedures regarding the financing of the working capital through bank credit. They feel that the lending norms followed by the banks based on the recommendations of the Tandon and Chore Committees are outdated and the entire system requires to be reviewed. Furthermore, it is represented that there is undue delay in taking a decision on their proposals requesting for renewal and/or enhancement of existing working capital limits.

2. Consequent to the issue of circular No.DBCD.Fol.BC 8/16. 13.100/92-93 dated July 27, 1992, reiterating the extant guidelines on discounting/rediscounting of bills as also on lending under consortium arrangement (viz., that banks should not extend any facility to a borrower (fund-based or non-fund based) without the consent of the existing bank/consortia), there have been an increasing number of representations made by the Chambers/Confederations/Associations of trade and industry regarding the hardship faced by the industry on account of lack of adequate and/or timely supply of credit for financing their operations. The main issues raised in different fora are as under :

- (a) Implementation of RBI guidelines would affect discounting of genuine trade bills ;

- (b) Restrictions imposed on banks for not extending credit to borrowers, where banks are neither regular bankers nor members of consortia, would result in non-availability of adequate bank credit in time;
- (c) Lending discipline evolved on the basis of the recommendations of the Tandon/Chore Committee, as modified from time to time, have become outdated; and
- (d) The guidelines related to lending under consortium arrangement should have more flexibility.

3. A series of discussions have been held with trade/industry/banks and at a high-level meeting chaired by Governor, Reserve Bank of India, on November 4, 1992, it was decided, inter alia, to constitute a Committee to review the system of lending under consortium arrangement. The Reserve Bank of India accordingly appoints a Committee under the chairmanship of Shri J.V.Shetty, Chairman and Managing Director, Canara Bank with the following members :

- | | |
|--|--------|
| 1. Shri Harbhajan Singh Executive Director Punjab National Bank New Delhi | Member |
| 2. Shri A.T.Pannirselvam Executive Director Bank of India Bombay | Member |
| 3. Shri D.Basu Deputy Managing Director State Bank of India Bombay | Member |
| 4. Mr.G.C.Dobby Chief Executive Officer The Hongkong and Shanghai Banking Corporation Limited Bombay | Member |
| 5. Mr.Jean Claude Tremosa Chief Executive Officer Banque Nationale De Paris Bombay | Member |

6. Shri P.K.Biswas Member-Secretary
Joint Chief Officer
Reserve Bank of India
Industrial & Export Credit
Department
Central Office
Bombay

The Committee may co-opt, if considered necessary any other institution/member to serve on the Committee or for any other reason.

4. The Committee is to review the extant guidelines on lending under consortium arrangement and suggest measures for improving the existing arrangement and/or any alternative system with the objective of improving efficiency of the banking system in delivery of credit.

5. The Committee is expected to submit its report within three months.¹

6. The secretarial services will be provided by the Industrial & Export Credit Department, Reserve Bank of India, Central Office, Bombay.

Sd/-

(D.R.Mehta)
Deputy Governor
January 5, 1993

¹ Extended up to end of August, 1993

APPENDIX II

Names of banks/institutions/organisations/
persons, who submitted oral/written
comments/suggestions/views to the Committee

(A) TRADE & INDUSTRY

1. Bombay Chamber of Commerce and Industry
2. Confederation of Indian Industry
3. Federation of Indian Chamber of Commerce and Industry
4. Federation of Indian Export Organisations
5. Indian Chamber of Commerce, Calcutta
6. The Associated Chamber of Commerce and Industry in India

(B) INDIVIDUAL INDUSTRY

1. Bharat Gears Limited, Bombay
2. Mutual Industries Limited, Bombay
3. Woolworth (India) Limited, Calcutta

(C) INDIVIDUALS

1. Shri S.Chintamani, Chief Manager, State Bank of India, Hong Kong
2. Shri Ramesh Gelli, Chairman, Vysya Bank Limited
3. Shri K.Kannan, Executive Director, Dena Bank
4. Shri B.R.Nayak, Assistant General Manager, Canara Bank
5. Dr.B.Ramachandra Rao, Director, Banking and Financial Consultancy Services, Hyderabad
6. Prof.A.K.Sen Gupta, National Institute of Bank Management, Pune
7. Shri Piyush Singhal, Managing Director, Lipi Data Systems, Bombay
8. Shri N.Vaghul, Chairman, Industrial Credit Investment Corporation of India Ltd.

(D) INSTITUTES

1. National Institute of Bank Management, Pune
2. The Institute of Chartered Accountants of India, Delhi

(E) BANKS

1. ABN - AMRO Bank
2. Allahabad Bank
3. American Express Bank
4. Andhra Bank
5. ANZ Grindlays Bank
6. Bank of America
7. Bank of Maharashtra
8. Barclays Bank
9. Bareilly Corporation Bank Limited
10. Canara Bank
11. Citibank
12. City Union Bank Limited
13. Corporation Bank
14. Dena Bank
15. Deutsche Bank
16. Hongkong Bank
17. Indian Bank
18. Indian Overseas Bank
19. Karnataka Bank Limited
20. New Bank of India
21. Oman International Bank
22. Oriental Bank of Commerce
23. Punjab and Sind Bank
24. Punjab National Bank
25. Scotiabank
26. Standard Chartered Bank
27. State Bank of India
28. State Bank of Mysore
29. State Bank of Patiala
30. State Bank of Saurashtra
31. Syndicate Bank
32. The Bank of Tokyo Limited
33. The Benares State Bank Limited
34. The Catholic Syrian Bank Limited
35. The Dhanalakshmi Bank Limited

- 36. The Federal Bank Limited
- 37. The Lakshmi Vilas Bank Limited
- 38. The Nedungadi Bank Limited
- 39. The Sakura Bank Limited
- 40. The United Western Bank Limited
- 41. UCO Bank
- 42. Union Bank of India
- 43. United Bank of India
- 44. Vijaya Bank

APPENDIX III

Consolidated statement of comments/suggestions/views of banks in reply to the questionnaire forwarded to them

Comments/suggestions/views of banks

| <u>State Bank of India and its associates</u> | <u>Nationalised Banks</u> | <u>Foreign Banks</u> | <u>Other Banks</u> |
|---|---------------------------|-------------------------|------------------------|
| (1) | (2) | (3) | (4) |
| (No. of respondents 3) | (No. of respondents 15) | (No. of respondents 12) | (No. of respondents 8) |

Question : Whether the present system lacks flexibility in respect of implementation of lending discipline and lending norms?

| | |
|--|---|
| <p>All the three respondents have felt that the present system lacks flexibility as it may not take into account changing market conditions in view of different opinions of member banks. State Bank of India has added that by itself the present system does not create inflexibility, but during implementation flexibility is affected due to aberrations.</p> | <p>Nine respondents have stated that the present system does not lack flexibility as deviations from norms are permissible. Three respondents have stated that if the lead bank plays its role effectively, the present system does not lack flexibility. Three respondents are of the view that the present system lacks flexibility because of delay in sanction of limits as also due to</p> |
| <p>Ten respondents have stated that the present system lacks flexibility as banks have to compulsorily conform to lending norms and lending discipline prescribed by the Reserve Bank of India. According to them these norms have become outdated as these are not in tune with the changing market conditions under which borrowers now have wider access to both capital market and secondary market.</p> | <p>Four respondents have stated that the present system lacks flexibility. Two respondents have stated that if the lead bank plays its role effectively, the present system does not lack flexibility. Two respondents have stated that the present system does not lack flexibility.</p> |

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inability of a consortium to respond quickly to borrower's changing credit needs.

Other two respondents, while stating that the present system lacks flexibility, have also stated that total flexibility is not desirable. According to them while the norms for inventory and receivables should be dispensed with, banks should strictly implement the lending discipline relating to maintenance of minimum current ratio. One of them has suggested that the system of need-based credit evaluation process be accompanied by a set of financial covenants, viz., total debt to be availed of by the borrower (inclusive of non-working capital/term sources), total liabilities/tangible net worth, quarterly finance information, disclosure/caps on capital expenditure and investments, cash flow, etc.

Question : Is it necessary to abolish the present system of consortium arrangement totally and replace it by a system of syndication or participation?

All the three respondents have stated that the present system can be made effective by modifications. State Bank of India is of the view that parameters like capital

Eleven respondents have stated that the consortium system cannot be replaced in the Indian context. According to them under participation/syndication it will be

Seven respondents have stated that the present system be replaced immediately by participation/syndication to meet the needs of the market.

Five respondents have suggested for continuation of the present system.

One respondent has suggested for

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adequacy, risk-weighted advance, exposure norms, etc., provide a code of conduct for banks whereas consortium arrangement ensures proper assessment of the credit needs and adherence to the lending discipline. Another respondent is of the view that syndication/participation may be considered for loans upto Rs.10 crore.

(2)

difficult to share pro-rata ancillary/foreign exchange business.

Two respondents have stated that new systems can be given a fair trial together with continuation of consortium arrangement. One of them has suggested adoption of participation/syndication because of recent developments like participation certificates with risk sharing, exposure limit ceiling in the case of individual banks, difficulties in completing joint documentation under SWCL and compliance with other formalities like joint appraisal, simultaneous sanction of limits, etc.

Two respondents have suggested total replacement of consortium arrangement by participation/syndication.

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Two respondents have suggested for gradual replacement.

One respondent is of the view that consortium arrangement may be made obligatory for limits of Rs.25 crore and above.

Two respondents are of the view that the system of syndication or participation can work well only in case of fixed loan or single transaction. As such in the Indian context consortium arrangement is best suited and hence the present system may be continued with modifications.

(4)

adoption of participation/syndication together with continuation of consortium arrangement

Two respondents have suggested for replacement of consortium system by participation/syndication.

Question : At present formation of consortium is obligatory for borrowers enjoying fund-based working capital limits of Rs.5 crore or more from more than one bank. Is it necessary to enhance the cut-off point and if so, what is to be the new cut-off point?

One respondent has suggested cut-off point of Rs.7.5 crore and

Continuation of present cut-off point of Rs.5 crore has been suggested by one

Five respondents feel that the question is irrelevant since

Retention of present cut-off point of Rs.5 crore - 3 respondents

| (1) | (2) | (3) | (4) |
|---|---|--|---|
| another has suggested Rs.10 crore. State Bank of India is of the view that increase in the cut-off point will not reduce the number of banks nor it will help the banking system in maintaining financial discipline. | respondent. Eleven respondents have suggested to enhance the cut-off point to Rs.10 crore. One respondent has suggested Rs.20 crore. Two respondents have suggested for decision by individual banks based on exposure limits of individual banks. | consortium arrangement itself needs to be abolished. Remaining respondents have suggested as under : Rs.5 crore - one(1) Rs.10 crore - two(2) Rs.25 crore - three(3) Rs.50 crore - one(1) | Rs.10 crore - 4 respondents Rs.15 crore - 1 respondent |

Question : Is it necessary to modify the present restriction of a maximum of 10 banks in a consortium in the context of the growing requirement of working capital by large borrowers?

Two respondents have stated for continuation of the present guidelines. One respondent is of the view that there is no harm in relaxing the number of banks, as such increase is generally warranted by the inability of the existing members to meet the demand for additional credit.

Five respondents have suggested for continuation of the present guidelines.

Three respondents have suggested for continuation of the current policy except in cases of large advances when shares of each member should be at least 5 to 10 per cent.

Seven respondents have suggested for removal of the restriction on number of banks.

Nine respondents have suggested for total removal of the restriction while three others feel that 10 members in a consortium is a maximum possible cohesive unit and only in case of really large advances, the number may be exceeded.

Five respondents are of the view that the present policy should continue in the interest of effective coordination among banks.

Three respondents have suggested that the number of banks may be left to the decision of the borrowers and banks.

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Question : There have been complaints that borrowers are not able to exercise their choice in selecting banks in a consortium as also influencing the sharing pattern among banks, thus losing out on competitive pricing. Is it, therefore, necessary to continue with the present practice or make the lead bank responsible for tying up with other banks or should it be left to the borrowers?

Respondents feel that choice of banks be decided by borrowers while banks may decide shares among themselves.

All the respondents feel that while borrowers may select banks, banks should decide about their shares so as to avoid unhealthy competition among banks relating to pricing of facilities.

Nine respondents feel that borrowers should decide about their financing banks. While two respondents have not offered specific comments, one has suggested that the lead bank/lead manager should constitute the consortium in accordance with the mandate of the borrower.

Seven respondents have suggested that borrowers should select their banks.

Question : Is it necessary to permit banks to freely enter into a consortium as also exit from it or the present practice in this respect should continue?

One respondent is for continuation of the present, one has not made comments and the third has suggested for both free entry and free exit for banks.

All the respondents have suggested for continuation of the present policy as otherwise banks will desert consortia financing sick/weak units. One modification suggested is that exit of a bank from a consortium be permitted if other members agree.

Eleven respondents have advocated for both free entry and free exit for banks. One respondent has suggested that consortium arrangement should be for a minimum determined period of two years.

Six respondents have advocated for continuation of present practice/policy while two have advocated for both free entry and free exit.

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Question : At present prescribed maximum time period for conveying a decision on a credit proposal is three months. There have been complaints about lack of prompt response on part of banks in taking decisions on loan proposals and instances have been cited by the trade and industry of proposals being decided after 6 to 8 months. According to trade and industry the time period should be considerably reduced and banks/consortia should be in a position to take decision within 15 to 45 days depending on the nature and size of loan proposals. What should, therefore, be the reasonable time period for sanction of different types of loan proposals?

All the three respondents feel that the period of 15 to 45 days suggested by trade and industry is inadequate for proper appraisal of large accounts and hence the present practice may be continued.

Ten respondents are of the view that advances requiring consortium arrangement being large require decisions by Boards of each member-bank. As such the present time limit of 90 days cannot be curtailed.

Respondents have suggested varying limits and majority is of the view that 45 days should be enough.

While one respondent has not offered specific comments, three have suggested for continuation of the present limit of 90 days. However, four have suggested to reduce the limit to 60 days.

Five respondents are of the view that the maximum time limit could be reduced to 60 days and it might be also possible to fix lower limit of 45 days for sanction of ad-hoc/renewed limits.

Question : Is it necessary to prescribe different time periods for arriving at a decision on loan proposals and for disbursement of loans after such decision is taken?

All have suggested for continuation of the present practice under which 30 to 45 days are required for

Some respondents feel that separate time limits are not necessary and overall time limit of 90 days

A few banks have suggested different time limits. All have suggested that disbursements can be

Respondents feel that disbursement is possible within 15 to 30 days of sanction.

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disbursement from the date of sanction.

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should continue. Others have suggested for 15 to 30 days separately.

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made only after completion of documentation. One respondent has suggested that lead bank may attend to documentation on behalf of all to reduce delay.

(4)

Question : Is it necessary to prescribe that in case the regular banker/consortium is not in a position to take decision on a loan proposal within the prescribed maximum time period, the borrower will be free to approach any bank in this regard?

Respondents feel that if consortium is not in a position to take a decision within 90 days borrowers should be permitted to approach another bank (to be inducted in the consortium or to lend after obtaining NOC).

Twelve respondents feel that borrower should be permitted to approach another bank under the said situation. One respondent, however, feels that in such cases lead bank may disburse on behalf of other members as permissible under the extant guidelines.

All the respondents feel that under the said situation borrowers can be permitted to approach another bank.

All the respondents are of the opinion that under the said situation borrowers can approach other banks provided the new entrant takes over existing dues of the members of the consortium.

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Question : Banks with minor shares in a consortium sometimes do not agree with the appraisal/assessment of working capital limits by the lead bank and/or the bank having the next largest share. Quite often, even after accepting their shares, some banks find it difficult to immediately disburse the same to the borrowers because of lack of funds. These instances might increase at a later date when all banks will be compulsorily required to follow norms in respect of capital adequacy, income recognition, etc. Under such situation is it felt necessary to debar entry/exit of a bank into/from a consortium?

Two respondents feel that under specified conditions entry/exit may be permitted.

While some have suggested entry/exit under specific circumstances (guidelines to

All respondents have suggested for entry/exit under the said situation.

Most of the respondents feel that banks may desert consortia financing sick/weak units under this pretext.

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be formed and followed in this regard), others feel that individual cases can be decided on merit.

Question : The terms and conditions of sanctions are finalised and required to be uniformly applied by all the member-banks in a consortium. Should this practice be allowed to continue or should the banks have freedom in pricing their shares of loans depending on their cost of funds and other services?

Respondents feel that pricing should preferably be uniform and if there is any differential, it can be sorted out by members. One respondent feels that differential, if any, should not be more than 0.5 per cent.

One respondent is of the view that this aspect should be left to the lender.

While all the respondents have suggested for uniformity in respect of terms and conditions, six are of the view that interest rates can vary among members.

Ten respondents have suggested that banks should have freedom in this regard.

Two respondents are of the view that terms and conditions should be strictly uniform.

While six respondents have suggested for continuation of the present policy of uniform terms and conditions for sanction, two have suggested that individual members may be permitted to charge different rates of interest.

10

Question : In the context of delay in documentation is it felt necessary to change the present practice of each individual bank in a consortium obtaining separate documentation? If so, please suggest the changed methodology to be followed to accelerate the process of documentation.

All the respondents feel that the present policy of SWLD should continue as it has reduced the time required for documentation.

All the respondents feel that IBA should sort out the difficulties so that the single window concept of documentation is implemented in all cases of consortium lending.

While all agree for a common documentation, some have suggested for removal of the clauses relating to 'power of attorney' to lead bank.

It would be desirable to have single documentation

(1)

(2)

(3)

(4)

Question : In case the lead bank is required to do various items of work in a consortium, should there be a fee for the lead bank for undertaking such services on behalf of the consortium?

Respondents are of the view that lead bank is entitled for such fee.

All the respondents feel that lead bank is entitled for fees from borrower for undertaking such services.

All the respondents feel that lead bank may charge such fees to the constituents/clients.

All the respondents are of the view that lead banks may charge such fees to the borrowers.

Question : Should bill discounting facility as also supply of export credit be continued to be kept within the consortium or borrowers be permitted to approach banks outside the consortium?

All the respondents are of the view that since banks assess total credit requirements of a borrowing unit, all types of limits should be within the consortium.

All the respondents are of the view that borrowers should not be sanctioned any facility/limit outside the consortium.

All the respondents are of the view that bill discounting and export credit can be availed of outside the consortium.

Except one respondent, others have suggested that all facilities should be within the consortium. One respondent has suggested that post-shipment credit can be availed of from outside the consortium.

Question : Is it necessary to change the present periodicity of consortium meetings held quarterly?

All the respondents feel that the present periodicity is correct, though one has also suggested to reduce it to twice every year.

Except three respondents, who have suggested half-yearly meetings, others have suggested to continue with the present periodicity.

While some respondents are in favour of continuing with quarterly meetings, others have felt that periodicity of meetings may be decided on need of individual borrowal accounts.

Five respondents feel that the present periodicity may continue.

Three others have suggested for half-yearly meetings and exchange of information on quarterly basis.

(1)

(2)

(3)

(4)

Question: Is it necessary for the Reserve Bank of India to intervene in cases where there are disputes in a consortium?

Two respondents feel that intervention of Reserve Bank of India is necessary, while the others feel it is not necessary.

Except one, other respondents have indicated that intervention of Reserve Bank of India is necessary as a last resort.

All the respondents are of the view that there should not be any reference to Reserve Bank of India unless the issue is related to policy matter/solvency of a bank, etc.

Six have suggested for intervention of Reserve Bank of India, one for intervention by Indian Banks' Association and the remaining one feels that disputes should be settled by the members themselves.

APPENDIX IV

Lending under consortium arrangement - a brief resume

The concept of lending on consortium/participation basis was mooted by the Reserve Bank of India as early as in 1974 and in the light of the experience gained, the instructions issued on the subject have been reviewed from time to time. The latest instructions on the subject were issued by the Reserve Bank of India in June, 1987, stipulating, inter alia, that -

- (i) in the case of parties enjoying fund-based credit facilities of Rs.5 crore or more from more than one bank, consortium arrangements should be made obligatory; and
- (ii) it would not be permissible to any bank outside the consortium to extend any additional credit facility by way of bill limits, guarantees/acceptances, letters of credit, etc., or open current accounts for the borrowers without the knowledge and concurrence of the members of the consortium.

2. Guidelines to banks

In order to bring about uniformity in the appraisal and operational techniques for provision of working capital facilities among banks financing each large borrower, formation of a regular consortium is being insisted upon. The bank taking the largest share in fund-based limits is required to function as the leader of the consortium. Detailed guidelines issued by the Reserve Bank of India on the roles and responsibilities of the leader and member banks are as under :

General guidelines/obligations

- (1) Banks to formalise consortium in cases where parties enjoying fund-based limits of Rs.5 crore

and more from more than one bank, with the bank taking largest share in fund-based limits to be the leader of consortium.

- (ii) To strike a balance between dispersal of risk and efficient decision in appraisal, sanction and follow-up of credit, the number of banks should not be more than around 10 in a formal consortium.
- (iii) The consortium should not resist the entry of a new bank to replace an existing member provided entire liability of the outgoing bank is taken over by the entrant bank.
- (iv) To avoid delay, the appraisal of the proposals is to be taken up :
 - (a) exclusively by the lead bank where that bank's share is more than 50 per cent of the fund-based facilities, and
 - (b) by lead bank alongwith another bank having the next largest share in other cases.

The note prepared by lead bank or lead bank together with the bank having the next largest share should be forwarded to other members for comments to be followed by a meeting to approve the appraisal note within a stipulated time frame of one month from the receipt of application.

- (v) The representatives of banks should convey 'in-principle' agreement at the meeting and for the purpose, banks are required to vest sufficient power in the executive attending the meeting. Competent authority's sanction is required to be conveyed (formal sanction) within 2 months of the meeting.
- (vi) In cases, where a bank faces temporary liquidity problem, the other member/s can take its share temporarily, and such bank taking up its share as soon as the position improves. It can execute a guarantee, if called upon to do so.

- (vii) Terms & conditions finalised at a consortium meeting should be applied uniformly. The drawings in the accounts and ancillary business should be in proportion to the credit sharing pattern. Any difference should be amicably settled through mutual discussion failing which the views of lead bank/lead bank and the bank with next largest share would prevail.
- (viii) The leader of consortium along with the bank having the second largest share would be responsible for arranging meeting on a quarterly basis and analysing the statements under the QIS and fixing operative limits to the borrower.
- (ix) Banks have been advised to adopt single window approach for documentation as well as first disbursement. A single set of documents, to be executed by the borrower with the lead bank, has been evolved by the Legal Committee of the IBA and has been circulated to banks for adoption. Similarly, for avoiding delay and inconvenience to the borrowers, the lead bank in all consortium arrangements should have the authority from each of the other member banks to make available its share of the entire/enhanced limits if the latter's decision is not conveyed to the lead bank in time. In such cases, the member, on whose behalf the disbursement is made, should reimburse the lead bank immediately on receiving the advice. For delays beyond a period of one week in effecting such reimbursement, the lead bank would be entitled to charge the delaying bank a penal interest of 2 per cent per annum for the entire period of delay. Disbursement by the lead bank would be in accordance with the immediate needs of the borrower.

3. Additional instructions in the case of sick/weak industrial units

- (i) Lead bank and the bank with the next largest share should be associated with the financial institutions in preparation of viability report and decision of these two banks would be accepted without demur by other members. Banks have been advised to develop necessary skill and expertise for the purpose.
- (ii) Where the viability of a unit is established and rehabilitation programme is drawn up with the acceptance of the lead financial institution and the two banks with the largest shares, the remaining banks in a consortium cannot dissociate themselves from the rehabilitation efforts/plans.
- (iii) The decision of the aforesaid two lead banks in the matter of the quantum of margin money for working capital shall be binding on other banks.