

# **Course Work**

## **Financial Law**

## **1. Introduction:**

No procedure in this world in any sector exists without any risk. Everything has its own pros and cons. Similarly is the case of drafting of loan agreement in syndicated loan. But before going to the risk assessment let's have a brief look on what do we mean by syndicated loan??Who gives and who takes?

A loan which is which is given by a bunch of players known as lenders and whose structural integration, documentation and administration is maintained by a group called as arrangers then that loan is called as syndicated loan. The arrangers include commercial and investment banks. The arranger mostly act as the investment banks by arranging investor, funds etc from the lender or issuer side and they get a fees for this service. The fees amount generally depends upon the risk factor associated with the loan. The syndicated loan became popular in 1960's after USA economy grew stronger and stronger with the help of this measure. This is one of the best ways to raise funds in a higher scale, for any investor.

For syndicated loan there is a syndicated agreement which is drafted for two main reasons-

- a) For maintaining good relationship between the members of syndication
- b) For maintenance of relationship between the members and the lead bank.

Let's have a small overview of how syndication process goes on so that we can analyse in a very better way what all risks are associated with it in agreement. The first process is the lead bank which will fund the loan and administer the loan chooses an agent who will

be then communicating in between the borrower and members of syndication or those financial institutions who will form the consortium. Sometimes it becomes easy if the agent has hand on experience before and the syndicated members know the borrower level and status, at times it takes time to make formal structure of the loan keeping the memorandum before the banks, giving presentation etc. After all such arrangements the duties of agents rises to two scales- one is contractual and auxiliary. In contractual duties the agent has to see that borrower is placing any condition or not prior to syndication, transfer of funds in between the borrower and the syndicated members, monitoring the transactions and taking necessary steps if anything is breached by the borrower. The auxiliary duties are taking notices from the borrower also keep updating about the borrower's financial statements and all to the syndicate members. Once all these processes are done and once the agreement is signed it is now mostly on the agent to carry on their interests.

The main objective behind the agreement of syndicated loan is to strike balance between the interest of the lenders, co lenders and the agent of the lead bank. Not only this to see that every clause and risk is well addressses as per the law in the agreement. This has to be defined and clearly mentioned while drafting by a lawyer and has to be kept in mind so that no legal issue arise. In the agreement there should not be biased decision by the agent if the agent knows the borrower. So in total the loan agreement is a sheet having all the details of the terms and conditions of the loan which is required for both the lenders and borrowers. Now coming on to the drafting part, loan drafting has some common structures such as.

- a) Contact information for all parties those who were in the consortium

- b) Objective of the loan by the borrower
- c) All payment options. Time schedule. Rates of interest
- d) Term length, and conditions for cancellations and all.
- e) Provisions and alternative of defaults.

This is the normal structure of a loan draft made by the lawyer. So for a syndicate loan too there are same basics but since bigger institutions are involved so there are certain level of risks are involved too. The main risks which were associated with the loan agreement drafting are.

## **2. Credit risk, interest risk, market risk, operation risk etc**

and second is that there are various clauses in the agreement that has to be abide by the law. Lets starts assessment one by one.

### **A) Credit Risk**

While drafting and outlining the loan agreement for government body in syndicate loan the lawyer has to kept in mind the credit worthiness of borrower as risk is inherently present when the responsibilities are large and also the where the credit extension to the borrower is also large. Everything should be clearly mentioned with a clause.

### **B) Market Risk**

While drafting the lawyer has to see the market risk associated with both the parties and see what all laws are available if the borrower becomes bankrupt due to the adverse market trends. So it should be addressed with material adverse change or force majeure clauses while documenting so that the risk can be limited to certain extent.

### **C ) Interest Rates Risk**

The degrees of interest risks vary depending upon the pricing of the deal and funding. Even though this risk is mostly handled by the treasury department but during making the agreement the lawyer should apply prepayment clauses in matter of safeguarding the redeployment of funds after the loss from any side. There should be clear mention of all types of provisions for claiming the loss due to prepayment of funds and that too before the interest dates abiding by clauses so that there will be no question of cheating or loss for the government entity in any case.

#### D) Operational Risk

As human beings are always prone to error so there is some amount of operational risk attached with the drafting due to negligence or over sighting. So there is every chance of mentioning of proper dates for the borrowers and lenders regarding the interest rates and drawdown and payments etc. So this has to be take care off during the drafting.

#### E ) Legal Risk

It can be assumed to be the most important risk attached to a drafting of syndicate loans. The person making the draft should kept in mind that all the terms and conditions mentioned in the loan agreement including interest rates, downpayments, shares etc are protected by clauses of the law so that no confusion should arise at the middle regarding this and in no way leads to the conflict of interest. It should also be kept in mind that this draft should be circulated among the lenders and borrowers with the option open for reviewing and giving suggestions at any point before the final drafting so that it will be as per the law and suited to protect the interest of all.

### **3. Components in draft**

Components in draft, which will lead us to the risks attached with it. In loan agreements especially with regard to the syndicate ones it comes with contracts and terms where there are two sides on one side there lies the government or sovereign entity and the other. All the agreements that are between the parties are abide by the public law elements even though there are some private law elements. But special care is taken to place public law to safeguard the interest of the agreement. As mentioned earlier in risks part that there are clauses which protects the interests of the parties similarly in agreement also there are clauses for the protection of the government entities, which should be take care of by the lawyer while drafting of the agreements. Let's have a look risks associated with this contextual part-

A) Preamble or the part where the purpose of the agreement or loan is mentioned. While drafting special care has to be taken by the lawyer to mention details of the agreement any flaws or any disputes at any points that have risen before regarding the agreement rather than only the addresses and plain objective of the loan. References has to be given there so that both the parties can see what has happened if parties have gone beyond the agreements or have not worked in accordance with the agreement.

B) Definitions in the clauses. As the matter is related to the international banking law then there would be definitely certain terms and definitions in the clause that may not be understood by all the parties in the consortium. Terms such as interest rates, business day, drawn pay etc are hard to understand. So lawyers while drafting such an agreement must

kept a note of that they should provide glossary so that these can be interpreted at the by all and can be understood with ease.

C ) Payout clause or the disbursement clause. This payout clause has the mentioning of the amounts of loan that has to be paid and to whom and in which date. All the details pertaining to this are drafted in the clause. Now the risk is suppose one of the members of the syndicate failed to provide its share of loan in due time then question will rise who will pay that amount? This should be ensured by the lawyer that the other member of the group who is compensating the amount must give an undertaking stating about this. Secondly, if the borrower doesn't take s the allocated amount in due time then there is a loss of interest as well as the breaching of guidelines as per the pacta sunt servanda because this will lead to the loss of participants fee and what sort of damage they will seek from the borrower. So lawyer should take special care about this of mentioning dates and the consequences along with references so that there will be no confusion from both sides and breaching of any guidelines will follow up with the mentioned consequence as per the private and public law.

D) Conditions precedents. which are the conditions that has to be fulfilled by the government entity seeking a loan from syndicate before the final agreement. That is the borrower should agree with the terms and conditions of the agreement and should give the consent of going forward by signing it which says that the borrower will be abide by the guidelines as prescribed in the agreement and will execute his powers within this limit. So lawyers should be careful while drafting to get the consent of the borrower in regard to this context.

E) Fees and interest these two things cannot be neglected when banking matters are concerned. Same principle is applied here. While drafting the loan agreement the lawyer has to keep in mind that the interest rates that has to be applied on the loan that borrower is allocated must go in accordance with the prime rates of U.S. customer or with the rules and regulations of LIBOR (London-Interbank offer rates) which is followed in those matters where the euro currency transactions are taking place. It has to be clearly mentioned in the agreement that the interest rate is determined not just by rules but also seeing the lending amount and a margin is fixed which has to be borne by the borrower along with the margin. The lawyer should take special care of mentioning about the overdue of interest rates and also mention that this interest is for the interest of the lending party as to compensate their loss if it is not paid at time by the borrower not for the profit of the lender party. Failure of paying the amount of interest will lead to the capitalisation of the amount from the borrower. It could be a risk in every way for not mentioning all these as these things affect the borrower's interest much. So after knowing these if the borrower thinks that it can go well with it, it will proceed. In every clause there has to be some references in concern with that market as it will lead to conviction of both the parties about the existence of such laws.

F) Repayment in the agreement holds much importance. In case of a syndicated loan the minimum time is six to twelve years for repayment if it is not done at one time as bullet style. But if it is followed by balloon style then even though the interest rates remain same the repayment amount goes on increasing thus leading to increase pressure on the borrower. So capital payment has to be done before the time. Lawyers should take special

attention in mentioning that if the borrower fails to repay the capital in stipulated time they may be asked by the lead bank to pay the full loan in stipulated time. Missing of this may lead to a fierce legal battle between the parties and borrower.

The thing or risk associated with the agreement is of the information exchange. It has to be clearly stated by the lawyer that the syndicating members at any time can ask for the legal status of the borrowers assets, and do any of the assets in borrower is under legal jurisdiction or not. So that the borrower will be able to maintain its records and can produce when necessary. Another is the default risk. This is one of the major clause which has to be mentioned in the agreement by the lawyer about the actions that can be taken if the loan repayment cannot be done by the borrower. The two reasons can be one the borrower cannot pay due to financial breakdown other the borrower has some other reasons. While the first reason may give borrowers some benefit but in the second one the borrower will not get any chance as the lending parties have full rights to take action before the due. So the lawyers should include all these things along with the negotiation clauses for a fruitful agreement which will not lead to any further mess.

Another important thing that has to be taken into consideration while drafting is the covenant that is some guidelines to which the borrower must abide irrespective of its positivity or negativity. This has to be mentioned by the lawyer in avoid to any risk. There are four other sub clauses under it such as budgets where when the government entity is doing a repayment then they must bear the signature of authority concerned mentioning that the repayment is included in budget of the country. Second sub clause is the approval of government under which it has to be stated that the government rules and

regulations on monetary matters should be made in such a way that it does not affect the way of repayment. Third one is the paripassu under which government entities are advised to take the loans in equal view irrespective of its type, if previous government has taken also then also the they have to look into the repayment issue. Fourth one is the reporting where the government agencies have to update the syndicates on financial matters from quarter to quarter for smooth transactions. So all these clauses have to be mentioned to avoid risk by the borrower.

#### **4. Conclusion:**

There are always exceptions so there are certain miscellaneous clauses that have to be mentioned too by the lawyer those are amendments, notices, clauses, costs etc. So these all have to mention and should be taken care so that proper risk management can be done. So in overall even though the major players are the parties syndicates and borrowers but without the intervention of the lawyer in drafting the loan agreement there cannot be single successful syndication loan in between the government entity and syndicate in current scenario.

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