A Study on Certain Aspects of Credit Syndication

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Abstract-*Credit Syndication occurs when the borrower requires large amount of fund. It will be accomplished with the help of group of lenders. This type of lending is possible only for larger projects such as for the corporate businesses. These type of loans are provided by financial companies and banks mostly. In this paper, we study the factors that influence the credit syndication. It involves in the identification of major characteristics for credit syndication. This paper depicts the syndicate loan market and estimates the structure and pricing of credit syndication. Global syndicated loans are represented with the help of charts and tables from Thomson reuters.*

Keywords-syndicate loan, corporate business, lenders, structure, pricing.

I. LITERATURE REVIEW

Barry Howcroft, Alper Kara and David Marques(3rd April, 2014) finds that the syndicated lending is opposite to bilateral lending when banks were targeting growth to utilize potential capital surpluses. And also finds that banks lend more through loan syndications when they are large and have higher capital adequacy ratios.

Steven A. Dennis and Donald J. Mullineaux(May 24,1999) analyses the market for syndicated loans and identifies the factors empirically, that influence a bank or nonbank's decision to syndicate a loan and the determinants of the proportion of the loan sold in the event of syndication.

Katerina Simons(February 1993) used some empirical tests to determine the relative importance of various factors that play a vital role in syndications of bank .In the same time; it finds support substantially for the necessity of bank regulation, in the form of capital requirements and lending limits.

Paul Schure,David scoones and Qinchuagu(January 2003) provides a new theory of loan syndication. Bank syndicates control sector risk by downsizing the industry when market demand fails to meet expectations. In this paper, they advance anew complementary theory of the bank syndicate.

Victoria Ivashina and David Scharfstein(May 2010) examines cyclicality in the supply of credit in the context of modern forms of banking and the adverse effect on reductions in bank capital on lending is determined and the role of syndicated lending is explained.

Blaise Gadanecz(December 2004) analyses the development of increasing markets globally and describes its functions, focuses on participants, mechanisms for pricing, primary origination and secondary trading. Also finds that large US and European banks tend to originate loan for emerging market borrowers and allocate them to local banks.

Jonathan Jones, William W. Lang and Peter Nigro (December 2000) extends the work of simons and dennis and mullineaux by estimating a multivariate cross-section regression model explaining agrnt bank's retained share of a syndicated loan.

II. INTRODUCTION

Credit syndication occurs when a borrower is in the need for a large amount of money; it is fulfilled with the help of syndicate loans. In this type of loan, many banks comes together to fund one borrowing party. The collection of banks providing the loan is called a syndicate.

When we approach a bank for a home loan, they would first assess the risks by appraising the property and your financial history. They also have a certain conditions on the amount they can make you available, based on the value of the property.

In the same way, lenders have limits on how much money they can lend to one borrower. If the amount that the borrower requires is too high, it might went out of the limit and the bank would be unable to approve the application. Credit syndication helps in this case. Credit syndication is also called as Loan syndication.

There are three types of people involved in the credit syndication process: (i) Arranger: It refers to the borrower who first approaches the bank (ii) Co-Arranger: It refers to the first group of banks to agree to syndication (iii) Co- Lenders: Various institutions that contribute towards the loan amount.

Agents will work for the lenders, but paid up by the borrowers. The agent's job is to ensure that the borrower complies with all the terms and conditions of the loan agreement. There are three stages in credit syndication, they are:

(i) Pre-mandate stage: When the borrower requires funds, they approach a bank that can act as the arranger, the borrower needs to give the arranger a letter (mandate letter) that contains all the necessary details and commitments.

(ii) Placing loan and Disbursement: Once this is done, both the lender and the borrower will produce and send an information memorandum to other potentially available lenders. This document should include all the information about the proposal for syndication and the borrower, including details about the project being funded.

(iii) Post-Closing stage: Once the formalities are completed and the banks have formed a syndicate, all that is left to do is appraise the project, which is usually undertaken by an appraisal institution. And the borrower is informed about the terms and conditions, a loan agreement is signed and the funds are released.

After the loan agreement is signed, the arranger takes responsibility for managing various tasks of administration such as loan applications processing, assignment of loan portions and interest payments to other syndicate members.

III. METHODOLOGY

For the study on factors influencing credit syndication, analysis of syndicated loan market, identification of the financial characteristics that measures the credit syndication and to estimate the flexibility in structure and pricing of credit syndication, secondary data has been obtained from Thomson reuters .Charts and tables are used to represent global syndicated loans.

(1) Factors influencing credit syndication

The important factors that influence the credit syndication are:

(a) Capital Position: Capital provides cushion to observe losses that may occur. It serves as a protective factor against the losses for depositors and guarantee fund to creditors. A bank with strong capital position can assure more credit risk than one with weak capital position. In fact, the former can follows liberal lending policy and can provides different types of loan includes long-term loans promising higher interest rates, in which the latter cannot do so because of greater risk involved.

(b) Earning Requirements: Making profit is one of the major objectives of a commercial bank. Some banks may be in a position to emphasis income, but other banks may stress on liquidity. And the banks that are all having a goal to set income as the major one of their lending would follow aggressive policy of lending and they might make larger amount of term loans or consumer loans which are normally made at higher interest rates because of greater amount of risks, they are facing. This suggestion does not mean that the banks would take under risks for accomplishing their objective of profitability.

(c) State of local and National Economy: In the formulation of syndicate loans, the banker should also keep in mind the economic conditions that are prevailing in the region served by the bank. If the economic conditions of the country are expected to improve the level of business activity, it is to increase banker's liberalisation in lending by relating credit standards and security requirements to accommodate those borrowers who were either refused banking faculties due to stiff credit.

(d) Monetary Policy: Through the variations in minimum reserve requirement and net liquidity ratio, central bank influences the lending ability of banks. Thus by reducing the proportion of minimum cash reserve, in which a commercial bank is required to carry with the central bank and reducing net liquidity ratio, it helps the banks to get additional funds which can be utilised in lending form. In this case, the cash reserve ratio and net liquidity ratio is increased and the lending ability of bank is limited.

(e) Competitive Position: The management should give the competitive position of the bank. The banks found that strong competing institutions exist, which may be in the field of term lending and the management feels that it cannot afford to provide the loans on terms being offered by other existing institution.

(2) Major Characteristics for Credit Syndication

Certain characteristics are adopted by credit syndication, they are described below:

(a) Principle of independent obligation banks: It disburses and collects their loans in accordance with the similar loan agreement, depends upon the independent relationship with the borrower. There are three aspects in this principle: (i) Lenders subject to their own obligations on the disbursement of loans to the borrower. Failure of lenders to disburse there in accordance with the loan agreement does not depend upon the disbursement obligations of other lenders. (ii) Based on the loan agreement, rights for creditors and their obligations are separate and independent and the debt of borrowers in each bank is also separate and independent. (iii) All creditors are entitled to exercise their rights independently, if it is not mentioned in the loan agreement.

(b) Clause Sharing in Syndicate loan: The lead bank is the deposit bank for the borrower and it has the large quantity of borrower's funds. Sharing the clauses is drawn to insure that all the members of consortium shared the risk equally in case of default. Sharing clauses will be mentioned in the loan agreement just because of ensuring that all consortium members fairly compensated and also to maintain better relationship among consortium members.

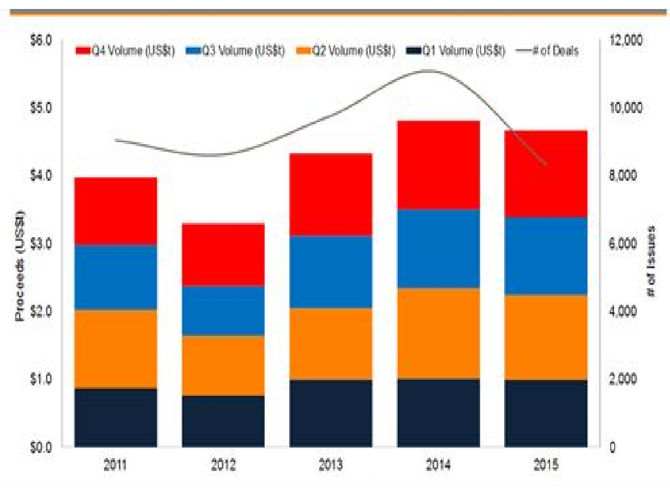
(3) Syndicate Loan market

There are three primary investors in syndicate loan market; they are banks, financial companies and institutional investors. Only bank and institutional investors are active.

(i) Banks – It can be commercial bank, a savings and loan institutions or a securities firm; it usually provides investment grade loans.

(ii) Financial companies – They have less than 10% of leveraged loan market and tends to play in smaller deals. This type of investors requires asset based loans.

(iii) Institutional investors – These investors are the structured vehicles. In addition to this investor, investors of hedge funds, high-yield bond funds, pension funds, insurance companies do participate in loans.



Source: Thomson Reuters

In the above chart, proceeds and the number of issues are compared for five years. The syndicated loan for each year is represented in dollars with certain volumes. It is predicted globally by estimating the issues and the deals associated with the lenders are calculated. differentiability of texture with respect to texture features in order to obtain greater

	Proceeds per Mandated Arranger US$m)					# of Deals per MA			Imputed Fees (US$m)		
Mandated Arrangers	2015 Rank	2014 Rank	Proceeds	Market Share%	Market Share Ch.	# of Deals	Market Share%	Change in # of Deals	Manager Fees	Market Share %	Market Share Ch.
JP Morgan	1	1	704,148.6	7.5	0.6 ▲	2430	10.3	-503 ▼	2,673.3	7.3	0.2 ▲
Bank of America Merrill Lynch	2	2	676,004.5	7.2	-0.4 ▼	2493	10.6	-176 ▼	2,763.0	7.6	-0.4 ▼
Citi	3	3	591,726.5	6.3	-0.3 ▼	1907	8.1	-175 ▼	2,134.5	5.8	-0.5 ▼
Barclays	4	4	489,504.8	5.2	-0.5 ▼	1638	7.0	-92 ▼	1,701.0	4.7	-0.5 ▼
Deutsche Bank	5	5	405,317.5	4.3	0.8 ▲	1612	6.8	-418 ▼	1,814.3	5.0	0.4 ▲
Wells Fargo & Co	6	6	387,128.6	4.1	-0.4 ▼	1914	8.1	95 ▲	1,501.1	4.1	-0.2 ▼
HSBC Holdings PLC	7	7	359,042.5	3.8	-0.2 ▼	1581	6.7	-264 ▼	1,041.3	2.9	0.0 -
Morgan Stanley	8	8	333,686.2	3.6	-0.2 ▼	1392	5.9	-143 ▼	1,587.6	4.3	0.0 -
Goldman Sachs & Co	9	9	324,449.9	3.5	0.0 -	1070	4.5	-112 ▼	1,642.3	4.5	-0.2 ▼
Credit Suisse	10	10	283,611.1	3.0	0.3 ▲	1046	4.4	-269 ▼	1,510.9	4.1	0.4 ▲

Source: Thomson Reuters

Global syndicated loans are provided in the above table. Mandated arrangers and their proceeds are represented with the rank for the year 2015 and 2015. And also the percentage of shares in the market and changes in share value are provided for each global arranger. For each global mandate arrangers, the deals are estimated with its share percentage and variations in share value. Imputed fees are also presented for the mandate arrangers. Imputed fees are the type of cost incurred by virtue of using an asset instead of investing.

(4) Structure and pricing of Syndicated loans

The syndicated loans are structured either by an investment bank or a commercial bank. After selected the lead bank, the next step is to structure the loan itself. It depends on the purpose of the company that wants loan, the creditworthiness of the borrower and the size of loan required by borrower. The syndicate loan can be structured with the elements of repayment. The elements for repayment are: (a) Re-payment on maturity: Certain loans are drawn down in full and then repaid on the maturity period at the end of the term, This can be varied by permitting companies either to drawn down the funds or to repay in instalments over the life time of loan. (b) Revolving Loan: Depends upon the terms for revolving loan, the company is required to repay the full loan amount at pre-determined points. Once repayment has been achieved, the terms of loan allow the company to draw down additional finance.

The pricing of syndicated loan is a particular interest to the banks and their supervisors. Loans are usually priced as a spread over the bank's interest rate. The interest rate paid by the borrower is adjusted for every three to six months based on the variations in market rate. In Europe, the pricing is done based on both the percentage over LIBOR (London Interbank Offer Rate) and over the US prime rate, and also the banks have an option to change from LIBOR to prime rate pricing. Borrower is normally given the choice between a three or six months readjustment period. A six months period is selected because of usually rising interest rates. Along with the interest rates, the fees payable on a syndicated loan are: (i) Margin (ii) Commitment fees (iii) Utilisation fees (iv) Arrangement fees (v) Legal fees.

IV. CONCLUSION

In this paper, we discussed certain aspects involved in credit syndication and the process of credit syndication is also explained. The factors that influence credit syndication are adopted by certain banks. Credit syndication have some major characteristics that are also included in this paper. Syndicate loan market, structure and pricing of syndicate loans are explained. In future, credit syndication on private banks in India will be get into research.