Distributed Ledger (Blockchain) - A way for simplification of syndication?

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Summary

Loan syndication has become an increasingly important part of corporate financing over the years. Syndication is a mechanism where in a group of banks fund the needs of a single borrower both funded and non-funded, for a wide variety of purposes. Initially developed to address the needs of huge, acquisition-hungry companies, they have now become a flexible funding source for both mid-sized companies and smaller companies that are on the cusp of moving into mid-sized status.

Several factors are responsible for driving the syndication business which include, the desire to share a large loan among several lenders to achieve diversification of loan portfolios, manage regulatory restrictions on the maximum exposure allowed for a single industry/borrower and capital constraints.

Current scenario

The whole syndication process/business is complex involving multiple parties probably across different geographies and exchange of lot of information. It starts with pre-syndication stage where a borrower approaches the lead manager/ arranger for his specific requirements, who in turn negotiates the broad terms and advises on the probable time to market. Then the proposal is made and forwarded to different banks for subscription or participation. Based on the interest evinced by the banks, the deal is finalized, participant lenders are confirmed and shares allotted. Pre-syndication in itself involves lot of information exchange like sending the proposal, recording of subscriptions etc.

Once the deal is struck between lead bank and participant banks, the lead bank communicates to the corporate customer about the syndicated facility arranged by it. As multiple parties are involved in the whole deal, an agent bank, whose primary responsibility is to administer the deal/ loan, now comes into picture. The agent would be the single point of contact for the borrower, monitoring compliance of the terms of the facility and, acting as the record keeper, paying agent. All the movement of funds happen through the agent bank normally, though in certain cases the payment agent bank may come into picture. The agent bank could also be responsible for maintaining the collaterals for the syndicated arrangement. The agent bank would charge some fee for facilitating these.

The agent bank on its part first records the deal/facility. It then records the tranches and keep a track of the compliance aspects of the agreed terms with the borrowers. Based on the funding requirements, the customer will give a notice to the agent bank for the funds, who in turn will request the participant banks for funds. The participant banks would arrange for the funds and pass on to the agent bank who in-turn passes this on to the borrower.

For repayments, the agent bank will receive the funds from the borrower and distribute it to the participant banks. Similarly, the agent bank acts as an intermediary for all communications that happen between the corporate customers and the participant banks like rate fixing, rate revision, loan repayment notice, among others.

Today the agent bank maintains all the critical information like the deal details, tranche details, and collaterals in its system. The participants do not have direct access to this information and will have to replicate the same in their systems. Lot of notices are involved from pre-syndication stage itself, like message about the grant of facility, amendment of facility, notice for commitment due, notice for drawdown, notice for rate review, notice for loan repayment which could be sent to either borrower, participant lenders or both.

In advanced markets, there could be sale and purchase of syndicated shares among banks where in, new participant lenders can come on record and existing ones cease to be on record. The syndicated arrangement could also involve issuance of Letters of Credit (LC) and Bank Guarantees (BG). These would also involve movement of lot of information and documents across involved parties.

All the above leads to duplication of information at several places, exchange of lot of information and documents through channels like SWIFT or physical movement. Also, there could be lot of manual interventions for various transactions. All these could lead to reduction in efficiency, transparency and increase lead time.

The way forward

One solution to minimize these challenges could be the adoption of distributed ledger or block chain technology for syndication.

By doing so, all parties of the syndicated deal, viz., corporate borrower(s), lead bank, agent bank, participant banks, payment bank etc. can be brought on to a single blockchain network. The agent bank can create and store this deal data, details of collaterals offered by the customer in the network so that all the participant banks can access the information from a single place. All parties in the network will have access to the deal data instead of just relying on the agent bank. If required, access restriction can be provided only to the required members of the network.

The borrower can send drawdown notice over the blockchain network and the agent bank can request the respective participants to contribute towards the drawdown request in the blockchain network itself.

Once the participant banks remit the funds for drawdown to the agent bank, participant banks can send confirmation over the blockchain network. Rate fixing or rate review notices can be communicated through the blockchain network. Any further notices like payment notice, and early payment notice can be stored in the blockchain network by the borrower and the same will be visible to all the participant banks.

The agent bank and participant banks can look at integrating their core banking systems (CBS) with the blockchain network for automation of various events and transactions. For example facility and tranche creations can happen through straight through processing of data from the network. When a participant receives a drawdown notice through the blockchain network from an agent bank, the information can be straight through processed to create a loan with the required details, drawdown of funds and the confirmation relayed back to the agent bank over the network which will update the drawdown contribution tracker in the agent bank's system. The interest rates can also be updated directly from the rate fixing notice sent by the agent over the network.

The borrower can also integrate his ERP system with the network and initiate LC/BG requests from their system.

The blockchain technology is already being looked at for usage in trade finance business like bills collection, open accounts, letters of credit and also in the payments world. Syndication business also involves trade products, payments or movement of funds across geographies. So moving ahead, bringing syndication on to the blockchain network is likely to add value and compliment these areas.

Benefits

Adoption of this technology could lead to benefits to all the parties involved in syndication from lead bank during pre-syndication to borrower during the life cycle.

Lead bank would be able to float the proposal of the syndication deal on the blockchain network to various likely participants who are on the same network, the interested participants can evince their interest on the network and the work-in-progress agreement with the terms and conditions can also be made available on the network so that it is visible to all and can be amended based on the inputs.

From the agent's perspective, as all details related to the deal are available on the network, they can be accessed by all the members in the network which results in greater transparency. Integration of the core banking system with the network will enable automatic updating of status like drawdown contribution, payment status etc. in the agent bank's systems. It could also be cost effective as there is no necessity to send notices, advices etc. over SWIFT which is very expensive. The agent could also maintain the various terms and conditions of the deal on the network with the status of compliance as fulfilled, partially fulfilled so that the participants will have the real time view.

Participant's perspective, as deal details like facility, tranche, collaterals etc. are available in the shared ledger, they can access these details anytime without relying too much on the agent bank. Integration with core banking system is likely to reduce manual intervention of transactions like drawdowns, rate review etc.

From the borrower's perspective, benefits include quick processing of drawdowns, issuance of Letters of Credit or Bank Guarantees due to reduction in communication time and possible automation.

Keeping in view the above, banks should definitely look at syndication as one of those areas where blockchain should be explored along with the current areas of interest like trade finance and payments.

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